SHORT TITLE

CANADIAN MONETARY POLICY AND THE SALES FINANCE INDUSTRY: 1953-62

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MONETARY POLICY AND THE SALES FINANCE INDUSTRY: THE CANADIAN EXPERIENCE, 1953-1962

by

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ABSTRACT

MONETARY POLICY AND THE SALES FINANCE INDUSTRY: THE CANADIAN EXPERIENCE, 1953-1962

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The procyclical and potentially misallocative and destabilizing demand for commodity instalment credit is highly interest-inelastic, and therefore virtually immune to conventional restrictive monetary policy. It was constrained during World War II and the Korean War by the regulation of down payments and repayment intervals. These devices were inapplicable during the mid-'fifties, so the acutely inflation-conscious Bank of Canada attempted to reduce the loanable funds of the sales finance industry by curtailing its bank credit. The attempt failed, because the abovementioned interest-inelasticity enabled the industry to utilize nonbank money sources. During the late-'fifties the Bank at least acquiesced in another such curtailment by the chartered banks while they invaded the industry's primary lending fields on a large scale. These events strengthened existing diversification tendencies within the industry, and may have increased thereby its vulnerability to the disturbances that shook it during the mid-'sixties.

PREFACE

Monetary authorities have traditionally regarded the phenomenon of commodity instalment credit as a potential source of difficulty in the execution of monetary policy, especially during times of high demand. Until the mid-'fifties, however, the policy-makers at the Bank of Canada, like their counterparts elsewhere, had always confined their efforts to regulate it to the imposition of minimum down payments and maximum repayment intervals. Then a new approach was adopted--the terms of commodity instalment credit were left undisturbed, but a concerted attempt was made (and justified in terms of the recently-formulated Gurley-Shaw thesis), to restrict the lending capacity of its predominant purveyor, the sales finance industry. Since this study is, au fond, an analysis and evaluation of this technique, on the above occasion and on a later one when substantially analogous events occurred, it may be presented as an original effort concerned with unprecedented Canadian experiences.

There is another aspect to be mentioned here. The presumption has long been commonplace, but untested, that, inasmuch as the central bank's basic role is to "lean" against the cyclical trend of total spending while those of the other financial institutions is to facilitate it, their directional influences must necessarily oppose one another. It seems likely that one reason for the failure of economists to investigate this presumption, with respect to Canadian experience at least, has been the unavailability of an objective system of identifying the thrust of Canadian monetary policy in terms of sufficiently small temporal units. Harry G. Johnson and John W.L. Winder therefore made a very useful contribution when, under the aegis of the Royal Commission on Banking and Finance, they constructed precisely such a classificatory system, covering an interval slightly longer than the one reviewed herein. By utilizing their work to examine this presumption in relation to a specific group of financial institutions this study has thus acquired a secondary element of originality.

Dr. J.A. Galbraith, Head, Department of Economic Research, Royal Bank of Canada, provided essential assistance with the initial conception of this study, and also made helpful comments at an intermediate stage. The Librarian and staff of the library of the Royal Bank made available much data and provided facilities for examining them. Mr. C.H. Bray, Executive Vice-President, Federated Council of Sales Finance Companies, was tireless in assisting the gathering of industry data. Dr. J. Singer, of W.A. Beckett Associates, also rendered generous assistance in this regard, as did Mr. A. Labatt, of McLeod, Young, Wier and Co., and Mr. K. Inch, of Industrial Acceptance Corporation Ltd. Several individuals within the financial community kindly granted interviews and provided useful information on a not-for-attribution basis. Professor A. Asimakopulos supervised the work, and gave of himself at every stage.

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INTRODUCTION

The primary function of the Canadian sales finance company is to provide commodity instalment credit--to purchase chattel mortgages on automobiles and, to a lesser but increasing extent, on various other goods. Consumers constitute the majority of its debtors, but entrepreneurs form a large minority. The latter is composed of three subgroups: automobile dealers, financing inventories; purchasers of commercial vehicles; and entrepreneurs borrowing to carry inventories, factor receivables and engage in capital formation. The growth of the sales finance industry in recent years has been remarkable. Within the Canadian financial sector it now ranks second only to the banks, in terms of assets held.

Sales finance companies obtain the wherewithal for their activities by borrowing from the banks, and by issuing debt and equity securities of various kinds. These lending activities and security issues are described in Chapter I, which then takes up another consideration. The volume of debt securities that the larger companies (who dominate the industry) issue has reached such proportions as to qualify them as important members of the set of institutions known as nonbank financial intermediaries, or near-banks. A discussion developed during the period covered by this study among students of monetary phenomena concerning the respective roles of banks and near-banks, and the manner in which they are and should be treated by the monetary authorities.

This was inspired by two writers, J.G. Gurley and E.S. Shaw, who maintained that there is no essential difference between these institutions. Because monetary authorities have traditionally operated, they further maintained, from an opposing conception, they have pursued policies that were bound, given the growth of near-banks, to become increasingly ineffectual against inflation and also inequitable to the banks. Specifically, Gurley and Shaw argued that the sale of near-bank liabilities and the concomitant purchase of near-bank assets tend to reduce the demand for money, and thus contribute to inflationary pressures. The central bank then allegedly responds by restricting the money supply. This confronts the banks with two painful choices: either to accept the destruction of part of their outstanding loans receivable or to liquidate other earning assets under unfavourable conditions. Either choice reduces their profits.

For the purposes of this study, it is useful to restate the mechanics of the foregoing in the following way. There exists, Gurley and Shaw notwithstanding, a basic functional difference between banks and near-banks such as sales finance companies. This difference arises from the fact that the liabilities of the former constitute money while those of the latter do not. That makes it appropriate to regard the borrowing and lending activities of sales finance companies as contributing to the velocity of circulation of money. Hence, there are two ways in which these companies may serve as vehicles of inflationary pressures. One way is by expanding the money supply through increased borrowing from the banks. The other way is by increasing the velocity of circulation of the existing money supply--by "activating inactive bank deposits". As to whether this behaviour is always inimical to the concurrent pursuits of the central bank, this is not a matter that can be determined merely by a priori reference to the premise that the former is inherently procyclical and the latter inherently contracyclical. Even if this premise were generally true, it would not necessarily follow that the monetary authorities always respond with restrictive action against the banks.

Thus, we have the following basic empirical questions to explore with respect to Canadian experience between 1953 and 1962:

1. Did the sales finance industry generally tend to promote inflationary (and deflationary) pressures?

2. Did it tend to oppose monetary policy?

3. If so, what was the response of the Bank of Canada? Was that response appropriate?

Before proceeding any further, it is necessary to consider various aspects of the Bank of Canada's perspective and modus operandi during these years. This is done in Chapter II. Mr. Coyne's pronouncements and general tactics leave no doubt that he was obsessed by the threat of inflation and saw himself as a much-maligned solitary crusader against its manifestations. The evidence, however, makes it clear that, with the exception of the sales finance industry, the Bank's management did not accept the basic Gurley-Shaw thesis as to the roles of banks and near-banks. It therefore implemented general monetary policy by operating on the cash reserves of the banks, leaving it to the market to allocate the money supply among financial institutions. We also learn something else of definite interest. When, during the mid-'fifties, the sales finance industry was seen by the Bank of Canada as a prime obstacle to anti-inflationary monetary policy and therefore subjected to drastically-reduced bank credit, it was also regarded as constituting unfair competition to the banks and the other near-banks. But in the late-'fifties, when the industry's bank credit was again restricted in analogous circumstances, the Bank took the view that institutional equity had been restored.

We next consider, in Chapter III, how the extension of commodity instalment credit might affect the economy. Although it cannot be asserted categorically that borrowers would not otherwise currently buy the goods they thus finance, or that their subsequent expenditures on goods are reduced by repayments, there exist plausible reasons for assuming that borrowing increases current aggregate demand and repayments decrease it, correspondingly. This assumption enables us to regard the change in the sales finance industry's total outstandings as the measure of the industry's direct impact on the level of current aggregate demand. This effect cannot, however, be evaluated in isolation from the general state of the economy. During boom times demand for all types of credit is high and, therefore, the loans made to these borrowers tend to represent loans denied to others. Hence, aggregate spending is probably not rendered much higher than it would otherwise have been. (The composition of total output is, of course, materially altered.) During slack times when demand for credit is low, no such diversion takes place. Consequently, the level of aggregate demand is elevated. This direct impact, however, is not the whole of the industry's effect on total spending. There are also accelerator-multiplier effects to consider. The accelerator aspects of these effects are impossible to evaluate in the abstract, but the multiplier ones are less difficult. It accordingly seems likely that, because of the periodic, fractional repayment mechanism of instalment credit, a given expansion in the industry's total outstandings will produce its most significant expansionary effects on the level of total spending in the first few subsequent periods. A simple hypothetical model, based on consumer commodity instalment outstandings in the U.S., suffices to suggest that the main impact of this type of credit may be two-fold. On the one hand, it may slightly delay and deepen the troughs in the general levels of economic activity but, on the other hand, it may strengthen the subsequent recoveries.

Another factor of relevance to the economic role of commodity instalment credit is the capacity of the producers of the goods whose acquisition it finances to promote economic instability in their own right. This capacity is attributable to the fact that the goods involved, especially automobiles, are relatively durable. Consequently, a substantial fluctuation in their demand is capable of generating correspondingly substantial fluctuations, via replacement cycles, in the future. In this context, sales financing should be seen as an accessory, rather than a prime mover, in the destabilising process; nevertheless, there thus exists an additional way in which the sales finance industry may contribute to economic fluctuations.

Chapter IV deals with the impact of the Canadian industry between 1953 and 1962. In his Annual Report for 1956, Mr. Coyne made the following assertions:

1. The industry generally tends to promote inflationary and deflationary pressures.

2. It also generally tends, unlike other financial intermediaries, to oppose monetary policy.

3. It is able to fend-off general anti-inflationary monetary policy because the demand for its facilities is more interest-inelastic than those for other types of credit. This enables the industry to attract funds by offering interest rates that the other intermediaries cannot match.

4. Thus, the industry, in addition to obstructing the stabilizing efforts of the Bank of Canada, also tends to channel spending into the area of consumer durables, at the expense of other areas more beneficial to the Canadian economy.

He also reported that the industry had rejected his requests for restraint during prevailing inflationary conditions, and that he had therefore instructed the banks to curtail their loans to its members.

Two groups of empirical data are available pertaining to the cyclical behaviour of the Canadian sales finance industry. They both tend to confirm that its total outstandings did, during the decade under review, vary in a strongly procyclical direction. They also tend to confirm that their peaks and troughs lagged slightly behind those of the general level of economic activity. (Similar implications emerge from roughly analogous U.S. data.)

In an effort to ascertain whether the industry's overall activities during this decade did, in fact, tend to oppose the thrust of monetary policy, an experiment was conducted. The Johnson-Winder qualitative classification of monetary policy was used as a temporal backdrop, on which were superimposed the movements of various indicators of the industry's lending operations. It was found that, subject to some significant exceptions, the industry did tend to work in opposition to the Bank of Canada. It was also found, however, that the same can be said of other suppliers of analogous forms of credit, including the banks.

The impact on the sales finance industry of monetary policy between 1953 and 1962--in both its general and specific forms--was, of course, part of the impact on it of the overall Canadian economic experience of that decade. It is therefore necessary to examine the former within the context of the latter. An analysis, in Chapter V, of the industry's internal development gives further substance to our earlier impression of striking growth. It also reveals a marked effort on the part of the industry to reduce its dependence on the banks as suppliers of loanable funds. This effort led it to make ever-increasing use of the money market, but, because of imperfections therein, it was forced to issue more long-term debt and equity securities than it would have liked. As a result, its rates of profits declined, especially during the later years. We can say, in summary, that while it is unlikely that the Bank of Canada ever succeeded in appreciably restricting the industry's outlay capabilities, it did cause it to significantly restructure both its outlays and its borrowings. (It also appears that the conventional view that the industry has the capacity of passing on to its debtors, and therefore paying to its creditors, relatively high interest rates is substantially, though not quite entirely, true.) To give substance to the foregoing, it is necessary to note the extremely high level of concentration within the industry. Three firms account for about two-thirds of its business. Of these, two, Industrial Acceptance Corporation and Traders Finance are relevant to this study. (The third, General Motors Acceptance Corporation, is not really vulnerable to Bank of Canada action.) An examination of its development confirms that IAC was always able to offset restricted bank credit by borrowing elsewhere. The same is also true of Traders Finance, but it, because of its dependence on the Ford Motor Company and less competent management, was not as successful as IAC was in taking advantage of the opportunities afforded by an expanding market. It also diversified into other areas of activity more than most other large companies did; though they all diversified widely during this decade.

The Gurley-Shaw-Coyne indictment of the sales finance industry was found in Chapters IV and V to be basically valid, with respect to the interval 1953-1962. The industry did constitute during those years a strong destabilizing force largely beyond the reach of general monetary policy. This was not the first time that it had functioned that way, nor was Canada's experience unique, before or during the 'fifties. Many other countries underwent similar experience with commodity instalment credit. They usually responded, as did Canada during World War II and the Korean War, by augmenting ordinary tight money policies with special regulations minimizing down payments and maximizing repayment intervals. Occasionally, the ability of sales finance companies to issue securities was also restricted.

As was implied earlier, it is doubtful whether these regulatory devices have ever succeeded (or ever can succeed by themselves) in rendering the aggregate level of spending very much lower than it would otherwise have been. The suppressed demand for consumer durables probably manifested itself in other forms of spending. Also, there is reason to believe that the subsequent lifting of these temporary controls unleashed the previously pent-up forces, although it must be admitted that this may usually have happened at times when the economy stood to benefit, being at a relatively low ebb. There also exist various other arguments for and against selective regulation by these means during peacetime. They add up the conclusion that no unqualified generalization is possible as to its net desirability. (About the most that can be said is that the combined use of controls on down-payments, repayment intervals and all borrowings by sales finance companies would at least reduce the volatility of the automobile industry. Even on this score, however, the fact is that an excise tax on automobiles would probably be more effective, as well as more equitable.)

Given the above considerations, the Bank of Canada's dilemma in 1955, when an almost unprecedented upsurge in demand for automobiles occurred, was a very awkward one. But the fact remains that the means chosen to resolve it were highly inappropriate. It is unlikely that they succeeded in curbing either the volatility of the producing industries involved or the existing inflationary pressures. The level of sales financing probably remained just as high as it would otherwise have been, with the large lenders expanding at the expense of the smaller ones, because of their access to non-bank credit.

There is a temptation to make a similar judgement with respect to the 1959 restrictions of bank credit to the industry. But, as was suggested above, this situation is more complex as regards the Bank's motivation than the earlier one was. A weighing of the evidence produces the impression that the Bank was attempting to restrict the industry more than the level of commodity instalment credit, and that may explain why it acquiesced in the entry of the banks into this field on a large scale. While it may well be that this was not an unwelcome development from its standpoint (after all, the chartered banks are vastly more malleable), the impact on the industry could only be negative. It strengthened its existing fears that the Bank of Canada had placed the mark of Cain on it. It made it even more concentrated than before. It substantially undermined its traditional pre-eminence in the field of commodity instalment credit, and augured-ill for its future role therein. Thus, it encouraged the industry to diversify, at an increasing rate, both its outlays and its borrowings. This dual diversification, as later events have tended to confirm, helped expose some of its members to serious liquidity problems.

CHAPTER I

THE CANADIAN SALES FINANCE INDUSTRY AND ITS FUNCTIONS

The Origin of the Canadian Sales Finance Industry

Canadian sales finance companies developed in response to a growing need for types of credit which neither the chartered banks, on the one hand, nor the trust, insurance and similar companies, on the other, could adequately provide. The former, by statutory constraint, confined their lending activities to the short term, while the latter, as a matter of basic policy, operated in the long. The evolution of the automobile, during the 1920's, from the status of a Veblenesque toy of the rich to that of the primary means of North American road transportation, created a demand for credit facilities which would make it accessible to the middle class. Given the reasonably determinate useful life of the automobile together with its other tangible features, it was an ideal intermediate-term chattel. In the decades that followed, similar facilities were created for various other consumer durable goods.

The volume of lending done by Canadian sales finance companies expanded as rapidly as its scope, especially in the post-World War II period. Large and growing volumes of loans were also extended to commercial and industrial establishments for capital formation and for the financing, or factoring, of their receivables. In addition, the industry's earlier inhibition against direct loans to consumers had, as the result of the acquisition or establishment of subsidiaries operating in that field, largely disappeared.[1] We will review these developments in some detail below; now it is useful to describe the general nature and operating characteristics of the organization known as the Canadian sales finance company.

Types of Loans Extended by Canadian Sales Finance Companies

In the retail field, the sales finance company comes on the scene operationally only when the retailer decides to convert his instalment receivables into cash. Having so decided, the dealer "sells" the acceptances, or contracts, in question to the sales finance company. The dealer remains ultimately responsible for the balance outstanding in the event of the customer's default, but he also retains ultimate repossession rights to the goods involved. (Usually, however, this liability and right are more nominal than real: the sales finance company generally takes over both.) The customer, when he buys on the instalment plan, undertakes to pay a specified finance charge, to be incorporated into his periodic remittances. The sales finance company usually agrees, as part of its predetermined arrangement with the dealer,

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[1] Submission by the Federated Council of Sales Finance Companies to The Royal Commission on Banking and Finance (cited hereafter as "FCSFC"), p. 7.

to share this income with him, subject to a specified "reserve" which is provisionally withheld for a variety of contingencies.

In its operations involving automobile dealers, the sales finance industry also carries on large scale "wholesale" lending, whereby the dealers finance their inventories of unsold vehicles. These lending activities are at once separate from and integral to loans to dealers on their retail operations. In a substantive, though not necessarily formal, sense the following procedure is generally adopted. The manufacturer, simultaneously with his shipment of the vehicles, turns over his receivable contract to the sales finance company designated by the dealer. After a delay corresponding to the transit period, the sales finance company pays the manufacturer the sale price of the shipment, and thus acquires his interest in the vehicles involved. When the dealer sells each vehicle, he remits its purchase price to the sales finance company plus a predetermined finance charge.[2]

One other aspect of sales finance company operations, closely linked to the two foregoing ones, relates primarily to automobile dealers[3]--the so-called "capital loans". Not infrequently, a dealer who wishes to expand or improve his premises or facilities is unable to obtain the necessary funds from other credit institutions. He

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[2] Ibid.

[3] Certain other types of retailers also obtain capital loans from sales finance companies, but they are aggregatively inconsequential.

then turns to the sales finance company with whom he does either or both his retail or wholesale business. (Indeed, the very fact that he maintains these relationships may inspire a distinct preference for using the sales finance company's facilities for these purposes.) Capital loans vary widely in type, ranging from outright unsecured loans to mortgages on immoveable property, and having terms extending from one to several years.[4] Although quantitatively a minor part of the overall operations of the sales finance industry, they are by no means insignificant to the stability of the relations between the sales finance company and the automobile dealer. The industry's lendings to commercial and industrial borrowers for capital formation and financing of accounts receivable are, as was noted above, widely varied and increasingly significant in scale, though their magnitudes still rank far below those just discussed. The mechanics are similar to those adopted by the conventional suppliers of these types of credit and need not be described in detail here.

Types of Liabilities Incurred by Canadian Sales Finance Companies

As for the sources of the sales finance industry's "product"—the use of money, they too have become quite variegated in recent times. In the early days, sales finance companies obtained almost all their funds from the sale of equities and by borrowing from the chartered

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[4] FCSFC, p. 23.

banks: the issue of bonds and debentures were rarely resorted to. This changed after World War II, when the traditional sources proved to be inadequate to meet the unprecedented levels of demand for consumer goods. The existing short-term securities markets in Canada amounted to little more than a mechanism for the issue of federal government securities, but with the advent of large-scale debt issues by one or two of the largest sales finance companies it began to evolve into what later became the first real money market in our history. Today, in a far more sophisticated institutional setting, sales finance company issues constitute one of the largest debt securities groups in the private field.

Most of the debt issues offered by the industry involve securities having maturities ranging from 30 days to 365 days, although some run for as long as three years. These short-term notes are usually secured in the same way that bank loans are: by instalment notes receivable having a nominal value in excess of the principal of the outstanding notes payable. The extent to which the industry has come to rely on this source of funds is indicated by its almost four-fold increase in volume, over an interval of only six years, to an average total debt amounting to some $1.6 billion by 1959-1961.[5] This of course connotes a very rapid and extensive evolution of market institutions and relationships, but many significant imperfections have remained. Moreover, the industry's activities in these areas are dominated by the handful of

[5] Ibid., p. 72.

large firms. Given their relatively short period of maturity, most short-term notes are not callable before due date. In an effort, therefore, to achieve the sort of flexibility that bank loans--the money source that short-term notes are intended to supplant--permit, the issuing firms spread out their maturities so that due dates arrive every few days. Hence, if additional short-term funds are not needed, they can simply retire maturing notes and refrain from issuing new ones. There exist, however, various institutional factors which tend to induce discontinuities in these flows. These are hinted at more than once in the industry's submission to the Porter Commission, by references to "the need to stay in the market for regular suppliers of short-term funds",[6] and the like. The nominal, if usually uninvoked, feature of most wholesale paper held by sales finance companies, namely that the loans in question are payable on demand, also confirms their existence. They are also implicit, as we will see further below, in the fact that the larger companies generally carry stocks of highly liquid marketable securities which give relatively low yields.

Similar market imperfections also exist with respect to the industry's long-term borrowings. These borrowings are generally accomplished by the issue of long-term notes payable and debentures. The former are secured, like their short-term counterparts, by

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[6] Ibid., p. 72.

predetermined amounts of instalment receivable paper,[7] while the latter constitute general charges against the borrowers' unpledged assets. Long-term notes issued by sales finance companies are often characterized by a number of interesting features. These include restrictions on the maximum total unsecured debt and on shareholders' equity, as well as penalty provisions for calling notes for redemption before maturity. There have been a few instances where the general public has been given the opportunity to participate in the purchase of these notes, but in the main they are sold to so-called "institutional" lenders, such as insurance companies.[8]

As might be expected, the sales finance industry strongly desires to avoid holding significantly more money than it can usefully employ at any given time. It has learned, however, that the short-term money market can be quite mercurial and the chartered banks even more so, as we will see in considerable detail below. Hence, basically, its emergence as a substantial borrower of long-term funds. But, as with its short-term borrowings, its long-term borrowings are subject to certain institutional factors. Something of their tensions and uncertainties can be discerned from even a cursory description of the use that the industry makes of another long-term borrowing device, the sale of debentures. Since debentures are unsecured liabilities, they

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[7]Indeed, they are usually issued in conformity with the same trust deed as short-term notes, with which they rank equally as to realization and other rights. (<u>FCSFC</u>, p. 75.)

[8]<u>Ibid</u>., pp. 75-76.

combine with equity to form the base on which specified maxima of other borrowings can be built. They also offer other advantages to the borrower, both intrinsically and in comparison with redeemable preferred shares, securities which perform partially analogous functions. For example, interest paid on debentures is, like interest costs generally, deductible from the taxable income of the issuer, while dividends on capital stock, preferred or common, are not. Perhaps for these very reasons, the sale of debentures by sales finance companies is usually subject to unique restrictions and reservations. These vary from provisions in debenture trust deeds requiring minimum past earnings and certain ratios between total debenture indebtedness and shareholders' equity, to attaching to the debentures common stock purchase warrants or conversion privileges. The former condition gives the lender some assurance as to the borrower's ability to make the necessary interest and principal payments, while the latter tends to encourage the lender to accept lower interest terms by offering him the opportunity to participate in the borrower's residual profits.

The sales finance industry's use of bank credit is but one part of a wider, more complicated relationship. A number of other factors are also involved. On the one hand, the banks have been emerging, increasingly in recent years, as competitors of the industry. On the other hand, the banks have been the major vehicle of monetary policy in general, and as directed towards the sales finance industry in particular. Specifically, the restriction of its bank credit has been the primary device with which the central bank has attempted to impose discipline on the industry. These, and related matters, are central to the theme of this study, and will be explored extensively below.

The Growth of the Canadian Sales Finance Industry within the Financial Sector

Canadian sales finance companies, together with consumer loan companies, today rank second (though distantly) to the chartered banks among Canada's main financial institutions, excluding life insurance companies and pension funds, in terms of total assets. Thirty years ago, the situation was radically different. Then, sales finance and consumer loan companies stood lowest by far among the group of seven. As Tables I-1 and I-2 show, these companies have over the last two decades been by this criterion among the fastest growing of Canada's financial institutions.[9] Even more striking overall progress was made by sales finance companies in terms of the absolute and relative growth of organizations operating in the field of consumer credit. This is indicated by Table I-3. The magnitudes involved are given some perspective by Table I-4, which gives ratios of consumer indebtedness, excluding personal mortgage debt, to personal disposable income for the postwar years to 1962. Over an interval during which this ratio expanded almost four-fold, the industry's share of total consumer

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[9] Report of the Royal Commission on Banking and Finance, Ottawa, Queen's Printer, 1964, pp. 106-7. (Cited hereafter as "Report".)

TABLE I-1

ASSETS OF THE MAIN FINANCIAL INSTITUTIONS
(millions of dollars, year end)

	1935	1945	1950	1955	1962
Bank of Canada	308	2,032	2,350	2,620	3,321
Chartered Banks[a]	2,514	5,997	7,918	10,440	14,848
Quebec Savings Banks	77	143	204	265	357
Trust Companies	225	266	441	714	1,877
Mortgage Loan Companies	230	235	367	570	1,286
Caisses Populaires and Credit Unions	11	140	302	643	1,666
Finance and Consumer Loan Companies[b]	80	100	468	1,244	2,247
Industrial Development Bank	-	10	31	45	181
Sub Total	3,445	8,923	12,081	16,541	25,693
Life Insurance Assets in Canada	1,991	3,125	4,304	6,043	9,950
Pension Funds[c]	n.a.	n.a.	875[e]	1,835[e]	4,572
Mutual Funds[c]	n.a.	n.a.	42	191	710
Sub Total	1,991	3,125	5,221	8,069	15,232
Fire and Casualty Insurance Assets in Canada	226	234	563	929	1,585
Total[d]	5,662	12,282	17,865	25,539	42,510
Primary Debt Outstanding	12,163	25,961	31,721	44,050	71,983
Institutional assets as a percent of primary debt	47%	47%	56%	58%	59%

[a] Canadian plus net foreign assets, excluding items in transit.

[b] In order to provide a consistent series we exclude some assets for which information is not available prior to 1960. At the end of 1962 total assets were $2,689 mn. compared to the $2,247 mn. shown.

[c] Data for pension funds and mutual funds in 1935 and 1945 are not available, but the amounts are known to have been small.

[d] The amounts shown include claims on financial institutions held by other institutions in the Table, for instance loans and holdings of cash. Thus, the total includes some double-counting of institutional assets.

[e] Estimated.

Source: Report of the Royal Commission on Banking and Finance.

TABLE I-2

ASSETS OF THE MAIN FINANCIAL INSTITUTIONS
(percent distribution)

	1935	1945	1950	1955	1962
Bank of Canada	5.4	16.5	13.2	10.3	7.6
Chartered Banks	44.4	48.8	44.3	40.9	34.9
Quebec Savings Banks	1.4	1.2	1.1	1.0	0.8
Trust Companies	4.0	2.2	2.5	2.8	4.4
Mortgage Loan Companies	4.1	1.9	2.1	2.2	3.0
Caisses Populaires and Credit Unions	0.2	1.1	1.7	2.5	3.9
Finance and Consumer Loan Companies	1.4	.8	2.6	4.9	5.3
Industrial Development Bank	-	0.1	0.2	0.2	0.4
Sub Total	60.8	72.7	67.6	64.8	60.4
Life Insurance Assets in Canada	35.2	25.4	24.1	23.7	23.4
Pension Funds	n.a.	n.a.	4.9	7.2	10.8
Mutual Funds	n.a.	n.a.	.2	.7	1.7
Sub Total	35.2	25.4	29.2	31.6	35.8
Fire and Casualty Insurance Assets in Canada	4.0	1.9	3.2	3.6	3.7
Total	100.0	100.0	100.0	100.0	100.0

Source: Report of the Royal Commission on Banking and Finance.

TABLE I-3

MAIN TYPES OF CONSUMER CREDIT OUTSTANDING
(December 31)

	Sales Finance Companies	Consumer Loan Companies	Retail Dealers	Chartered Banks	Credit Unions and Caisses Populaires[a]	Other[b]	Total
				$ MILLIONS			
1945	8	30[e]	100[e]	73	25	152	388
1950	202	93	454	224	76	182	1,231
1953	516	176	624	308	133	233	1,990
1956	756	356	798	435	209	281	2,835
1957	780	362	826	421	249	308	2,946
1958	768	401	861	553	294	317	3,194
1959	806	484	915	719	363	336	3,623
1960	828	549	960	857	417	358	3,969
1961	756	594	1,006	1,030	503	375	4,264
1962	771	689	1,039	1,183	560[e]	398	4,640
				PERCENT DISTRIBUTION			
1945	2.1	7.7[e]	25.8[e]	18.8	6.4	39.2	100.0
1950	16.4	7.6	36.9	18.2	6.2	14.8	100.0
1953	25.9	8.8	31.4	15.5	6.7	11.7	100.0
1956	26.7	12.6	28.1	15.3	7.4	9.9	100.0
1957	26.5	12.3	28.0	14.3	8.5	10.5	100.0
1958	24.0	12.6	26.9	17.3	9.2	9.9	100.0
1959	22.2	13.4	25.3	19.8	10.0	9.3	100.0
1960	20.9	13.8	24.2	21.6	10.5	9.0	100.0
1961	17.7	13.9	23.6	24.2	11.8	8.8	100.0
1962	16.6	14.8	22.4	25.5	12.1	8.6	100.0

a Includes small amounts of caisses populaires non-personal lending.
b Principally insurance company policy loans: also including Quebec Savings Banks.
e Estimated.

Source: Report of the Royal Commission on Banking and Finance.

TABLE I-4

RATIO OF CONSUMER CREDIT TO PERSONAL DISPOSABLE INCOME

	Consumer Credit	Personal Disposable Income	Ratio
Year-end	$ mn	$ mn	%
1945	388	8,617	4.5
1950	1,231	13,670	9.0
1953	1,990	16,848	11.8
1956	2,835	20,888	13.6
1958	3,194	23,362	13.7
1959	3,623	24,526	14.8
1960	3,969	25,486	15.6
1961	4,264	27,086	15.7
1962	4,640	28,646	16.2

Note: If estimated personal mortgage debt were included, the ratio of all consumer debt to personal disposable income would be approximately 50%.

Source: Report of the Royal Commission on Banking and Finance.

credit outstanding expanded eight-fold. This quite remarkable rate of growth is underscored by the behaviour of the other suppliers of consumer credit, shown on Table I-3. The experience of the chartered banks during these years is especially significant, and will be explored below. Here, it might be noted merely that the relative shares of the consumer credit field held by sales finance companies and banks, as groups, have tended to vary in opposite directions. It will be observed, moreover, that this tendency was particularly strong during the latter part of the 'fifties and the start of the 'sixties--years during which the activities of the Bank of Canada and its Governor were especially "notable"--and that the relative share of sales finance companies declined throughout. (The same interval, on the other hand, saw the consumer loan company group, with which members of the sales finance industry have become increasingly involved, on the whole retain its relative share of the field.)

Some Preliminary Observations concerning the Internal Development of the Canadian Sales Finance Industry

We will have occasion in a later chapter to analyse the internal development of the industry, during the decade under review, in considerable detail. There the purpose will be to infer the impact on it of monetary policy, in both its general form and its specific manifestations *vis-à-vis* the industry. It is useful, however, at this stage, to note briefly a few broad aspects of this internal development.

If one thinks of the financing of the inventories of automobile dealers as being basically part of the field of consumer credit, then it can be seen from Table I-5 that the interval between 1951 and 1962 saw the industry start and end with 70% of its receivables concentrated there. But this represents the interval's minimum. Actually, the industry's relative degree of involvement in that field rose quite sharply during the first few years of the 'fifties and then, somewhat less rapidly, returned to its initial level. Its absolute commitment more than trebled. If, however, inventory loans to automobile dealers are separated, the Table shows that the industry's proportionate commitment to financings of vehicles sold to private consumers and its proportionate commitment to financings of vehicles not yet sold (i.e., wholesale finance) changed quite frequently in relation to each other. Sometimes they varied inversely rather sharply, as between 1951-53; at other times they moved together, as say, between 1959-61.[10]

The financing of vehicles bought by commercial and industrial firms provided by sales finance companies also varied significantly during this interval. Furthermore, since these users of vehicles, like private ones, generally acquire them from dealers, it is likely that there also exists a relationship between this type of industry activity and its dealer inventory lending. It is interesting that while the relative deployment of the industry's lending reflects a volatile and,

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[10]This financing covers both new and used vehicles.

TABLE I-5

SALES FINANCE COMPANIES: MAIN RECEIVABLES[a]

	Consumer Goods			"Wholesale" Finance[b]	Commercial and Industrial			Total
	Cars	Other	Total		Vehicles	Other	Total	
				$ MILLIONS				
1951	161	24	186	108	95	33	128	421
1953	411	105	516	115	123	61	184	816
1955	478	121	599	145	106	85	192	936
1957	636	144	780	202	135	153	288	1,269
1959	610	196	806	197	138	206	344	1,346
1961	569	187	756	184	138	257	395	1,335
1962	593	179	771	237	146	279	425	1,433
				PERCENT DISTRIBUTION				
1951	38.2	5.7	44.2	25.7	22.6	7.8	30.4	100.0
1953	50.4	12.9	63.2	14.1	15.1	7.5	22.5	100.0
1955	51.1	12.9	64.0	15.5	11.3	9.1	20.5	100.0
1957	50.1	11.3	61.5	16.0	10.6	12.1	22.7	100.0
1959	45.3	14.5	59.8	14.6	10.2	15.3	25.5	100.0
1961	42.6	14.0	56.6	13.8	10.3	19.2	29.6	100.0
1962	41.4	12.5	53.8	16.5	10.2	19.5	29.7	100.0

[a] This Table does not include some additional business receivables for which information is not available prior to 1960. A recently published DBS survey of financial institutions indicates that these receivables increased from $77 million at the end of 1960 to $259 million two years later. (See DBS publication No. 61,006.)

[b] This category consists of loans to automobile dealers for inventory financing.

Source: Report of the Royal Commission on Banking and Finance.

over most of the interval, a decreasing tendency with respect to privately purchased vehicles, it decreased very sharply at first but later became stabilized in the case of vehicles sold to firms.

Significant developments also occurred in the industry's other areas of activity, as is further apparent from Table I-5. Its relative commitment of lending capacity to "other" consumer goods rose sharply between 1951 and 1953, and then tended to fluctuate around that higher level. The relative share of "other" commercial and industrial financing, on the other hand, has only recently begun to show signs of reaching a plateau, having been subject to an appreciable growth rate throughout most of the 'fifties. Again, given the overall growth of the industry during this period, these increases loom even larger when viewed in absolute terms.

Table I-6 gives an overview of the industry's operations as a borrower or other acquirer of funds during the same period. Since money is the industry's only "input" and "output" it is obvious that the absolute changes reviewed above in its receivables will, in the aggregate, occur correspondingly in its liabilities. As regards the composition of those liabilities, the trend towards long rather than short-term borrowing has already been noted. Here, it might be observed further that it is misleading, however, to think in terms of the industry as a whole. The Table gives figures only for the aggregate of the firms outside of the ten largest companies for the year 1962, but this is enough to raise the suspicion that the experiences and situations of the two groups

TABLE I-6

LIABILITIES OF SALES FINANCE COMPANIES[a]

	Bank Loans	Short Term Notes	Long Term Notes[b]	Bonds and Debentures	Other Liabilities[c]	Capital and Reserves	Total
				$ MILLIONS			
1953, 10 largest companies	191	212	140	104	108	84	839
1957, 10 largest companies	156	409	227	193	158	143	1,286
1962, 10 largest companies	90	515	691		277	241	1,814
1962, all other companies	65	49	44		37	47	242
1962, TOTAL	155	564	735		314	288	2,056
				PERCENT DISTRIBUTION			
1953, 10 largest companies	22.8	25.2	16.7	12.4	12.9	10.0	100.0
1957, 10 largest companies	12.1	31.8	17.7	15.0	12.3	11.1	100.0
1962, 10 largest companies	5.0	28.4	38.1		15.3	13.3	100.0
1962, all other companies	26.9	20.2	18.2		15.3	19.4	100.0
1962, TOTAL	7.5	27.4	35.7		15.3	14.0	100.0

a The 10 largest companies are those reported in the submission of the Federated Council of Sales Finance Companies. Data for 1953 and 1957 are from Table 6-1 of the submission and refer to fiscal year ends. Calendar year end data for 1962 are from the DBS survey of sales finance companies.

b Two years and over.

c Principally accounts payable, unearned service charges and dealer reserves.

Source: Report of the Royal Commission on Banking and Finance.

were markedly different. These and similar possibilities have a variety of implications which, given the high degree of concentration that prevails within the industry, have, as we will see below, a definite qualitative as well as quantitative significance. Much the same may be said, a fortiori (as will also be seen below), of the use made of bank loans during the interval.

A preliminary word about profits is in order at this point. Table I-7 gives a summary of the operating results of sales finance companies and consumer loan companies for the years 1954, 1957 and 1961 in respect of the former, and for 1957 and 1961 in respect of the latter. The virtual absence of standardized accounting techniques and terminology, beyond certain minima, renders any attempt to make comparisons between firms within the same industry, to say nothing of firms operating in different industries, a very treacherous business indeed. Still, it might be observed, while acknowledging this caveat, that the after-tax profits of both types of financial institutions, expressed as a percentage of total assets, do not appear to have been notably unstable over the years. They also apparently compare rather favourably with the rates of profit earned by other Canadian financial intermediaries. This seems to be especially true of the consumer loan companies. The Porter Commission found, for example, that these companies earned a rate of profit that is double those earned by mortgage loan companies and banks. As for the sales finance companies, their profit rates were appreciably lower than those of the consumer loan companies--a fact

TABLE I-7

REVENUES AND EXPENSES
(percent of total assets)

	Sales Finance Companies[a]			Consumer Loan Companies[b]	
	1954	1957	1961	1957	1961
Revenue	10.1	9.7	9.7	18.0	17.6
Less: Administrative expenses	3.2	2.7	2.7	7.7	6.8
NET	6.9	7.0	6.9	10.3	10.8
Less: Interest on borrowed funds	3.2	3.9	3.7	4.1	4.7
NET	3.7	3.1	3.2	6.2	6.1
Provision for losses and reserves, net	0.5	0.3	0.5	1.1	1.1
Taxes	1.6	1.3	1.4	2.3	2.6
Net Profit	1.6	1.5	1.4	2.9	2.4
Dividends	1.1	0.9	0.9	0.9	1.5
Retained Earnings	0.5	0.6	0.5	2.0	0.9

[a] Ten largest companies.

[b] Prior to 1957 the definition of small loans was different so that the revenues and expenses reported by the Superintendent of Insurance are not comparable with later years.

Source: Report of the Royal Commission on Banking and Finance.

that seems clearly related to the abovenoted tendency of sales finance companies to move into the area of cash loans to consumers--but, again, they remained higher than those of the other financial intermediaries.[11] Significantly, however, the gap has been narrowing of late, and it has been suggested that this tendency is likely to continue, "since it does not appear that the competitive adjustment of market shares with other institutions is yet complete, and the sales finance companies may lose further ground relatively."[12] The forces behind this tendency are of distinct relevance to this study, and they will be examined in detail below.

The Sales Finance Company as Near-bank; the Gurley-Shaw Thesis

As Table I-6 shows, the larger firms within the Canadian sales finance industry became, during the 'fifties, large-scale sellers of debt securities of various kinds. They thus qualified as important members of the set of institutions known as nonbank financial intermediaries, or near-banks. This decade also witnessed a discussion among students of monetary phenomena as to the respective roles of banks and near-banks, and the manner in which they are and should be treated by the monetary authorities.

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[11] Report, p. 216.

[12] Ibid., pp. 215-16.

The discussion was provoked by two writers, John G. Gurley and Edward S. Shaw, who fired their opening salvo in an article that appeared in 1955.[13] Later, they both defended and expanded their ideas in various articles and addresses and, finally, in a book published in 1960.[14] The analytical framework they developed affords access to so many important theoretical and practical issues that a conscious effort is necessary to avoid digressing away from those aspects of their overall contribution that are most relevant to this study. Suffice it to say, then, that their basic contention is that, numerous observable differences notwithstanding, there exists an essential similarity between banks and near-banks. Both types of institutions "intermediate in the transfer of unspent incomes from surplus to deficit [spending] units."[15] They also have a similar capability for generating inflationary pressure.

> "Inflationary pressure may be created...by an increase in the supply of money or by a decrease in the demand for money, or both....

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[13] J.G. Gurley and E.S. Shaw, "Financial Aspects of Economic Development," American Economic Review, XLV, September, 1955, pp. 515-38.

[14] See in particular, "Financial Intermediaries and the Saving-Investment Process," Journal of Finance, XI, May, 1956, pp. 257-76; Money in a Theory of Finance, The Brookings Institution, Washington, 1960; and the address by Gurley cited below. Additional references will be found in the bibliography.

[15] J.G. Gurley and E.S. Shaw, Money in a Theory of Finance, p. 243. The matter of the degree of functional similarity between banks and near-banks has been a subject of considerable controversy. An analysis that avoids many of the semantic entanglements that characterize much of the discussion can be found in J.A. Galbraith, The Economics of Banking Operations, McGill University Press, Montreal, 1963, pp. 29-53.

> "There is no question...that the [banks] can add to inflationary pressure by increasing the money supply, given the demand for it. <u>But [near-banks] can also add to inflationary pressure, not by increasing the money supply, to be sure, but by reducing the demand for money, that is, by raising V.</u>"[16]

The underlined passage goes to the heart of the matter, as far as near-banks like sales finance companies are concerned. When sales finance companies offer instruments of liability they seek to attract money in order to lend it to others as soon as possible thereafter. By this means, as well as by lending money obtained directly from the banks, they engage in activity that has a palpable inflationary potential. They are capable, in other words, of serving as vehicles of both an expansion of the money supply and of an increase in its velocity of circulation.

As a possible consequence, according to Gurley and Shaw, the central bank may choose to remove this excessive availability of money. Then bank reserves, earning assets, deposits, and profits are contracted. Even if the central bank does not so react, however, the banks still suffer. They must either carry excess reserves or accept a narrower spread between the interest rates they earn and those they pay. Moreover, their competitive position in the monetary sector deteriorates.[17]

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[16] J.G. Gurley, "Financial Institutions in the Saving-Investment Process," an address before the 1959 Conference on Savings and Residential Financing, sponsored by the United States Savings and Loan League. Reprinted in L.S. Ritter (ed.), <u>Money and Economic Activity: Readings in Money and Banking</u>, Houghton Mifflin, Boston, 1961, p. 323.

[17] J.G. Gurley and E.S. Shaw, "Financial Intermediaries and the Saving-Investment Process," <u>Journal of Finance</u>, XI, May, 1956, pp. 261-62.

Some Basic Issues

Thus, the Gurley-Shaw thesis, as applied to the Canadian sales finance industry, holds that the industry is a potential obstruction to anti-inflationary monetary policy and, in addition, could cause the chartered banks to suffer inequitable consequences. The validity of these contentions, with respect to any particular period of time, cannot, however, be determined in the abstract, by referring, for example, to the facile notion that the sales finance industry operates in an inherently procyclical fashion while the Bank of Canada's behaviour is inherently contracyclical. Even if this were manifestly true, it would not necessarily follow that the Bank must take inequitable offsetting action against the chartered banks.

Accordingly, the following are some of the basic questions that will be investigated below, with respect to the years 1953 to 1962.

1. What was the nature of the impact of the sales finance industry on the Canadian economy during this decade?

2. Did the industry tend to oppose and undermine monetary policy during those years?

3. If so, what were the reactions of the Bank of Canada?

4. Were those reactions appropriate?

CHAPTER II

THE GOALS AND TECHNIQUES OF THE BANK OF CANADA; 1953-1962

The Broad Goals: The Importance of the Vision and Style of the Governor of the Bank of Canada

In its broadest sense, monetary policy, to paraphrase Professor Viner's famous aphorism, is what central bankers do. One can add to that, on the basis of Canada's experience during the late 'fifties and early 'sixties, that it is also what they say they do, what they say they want to do, and what the public thinks they do. As to what Canadian central bankers are intended (by Parliament) to do, that, at least, is abundantly if unhelpfully clear. Their task is nothing less than

> "...to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion."[1]

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[1] Submission by the Bank of Canada to the Royal Commission on Banking and Finance, pp. 113-14. This document will be cited hereafter as Submission: Bank of Canada.

Looking back over the past two decades of Canadian economic history makes it plain that there is little to be gained in the way of an understanding of the nature and purposes of the behaviour of our monetary authorities by merely referring to legislation and the like. That understanding must be sought in the deeds and the accompanying words (where such were uttered) of the Bank of Canada's management, as personified usually by its Governor. Another source, which is of particular importance with respect to the Coyne era, an era of critical relevance to this study, consists of the views expressed by the Governor on the diverse economic and related issues that have confronted us over the years. For, as Professor Sayers aptly puts it: "The essence of central banking is <u>discretionary</u> control of the monetary system.... The central banker is the man who exercises his discretion, <u>not the machine that works according to rule</u>."[2] The "rule", as far as Canada is concerned, is in any case an unspecified one.[3] The primary determinants of the activities of her central bank have at any given time therefore emerged from the overall perspective and the <u>modus operandi</u> of its Governor.

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[2] R.S. Sayers, <u>Central Banking After Bagehot</u>, Oxford, Clarendon Press, 1958, p. 1. (Emphasis added.)

[3] <u>Submission: Bank of Canada</u>, p. 114.

The Visions and Styles of the First Two Governors of the Bank of Canada

These *modi operandi* have varied a great deal, in spite of the fact that there have only been three Governors since the Bank of Canada was established in 1934. Those of the first two are particularly relevant to this study. The frame of reference of the first Governor, whose tenure extended into the early post-World War II period, was defined by the Great Depression of the 'thirties. In thus perceiving reality, Mr. Graham F. Towers resembled his opposite numbers throughout the western world, especially in Britain and the United States, as well as most senior civil servants and academic economists. He therefore responded passively to the strong inflationary pressures that characterized the late 'forties, regarding them as but the legacy of wartime controls and restrictions. Once these and related transitional forces had spent themselves, he expected, the familiar syndrome associated with an inadequate level of aggregate demand would again emerge.[4] Another reason why he was willing to tolerate a very substantial degree of inflation in those days was his strong commitment to firm bond prices and stable bond markets. To further illustrate his outlook it is notable that what might otherwise have been recognized as a highly portentous development--the increasing inflow of U.S. capital into

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[4]For a quite full accounting of his postwar operations and their underlying reasons, see his testimony published in Canada, House of Commons, *Proceedings in the Standing Committee on Banking and Commerce*, March 18, 1954, pp. 3-13.

Canada--inspired no observable misgivings in his mind. He probably regarded it as yet another bulwark, at least in the short run, against excess capacity, and as such deserving only to be welcomed. This general attitude persisted until the outbreak, in June, 1950, of the Korean War.

It is, however, true that from then until his retirement in early 1955, Mr. Towers functioned in a rather less permissive fashion. He took prompt and definite action to choke off the upsurge of demand for consumer durables that was sparked by the outbreak of the Korean war. He abandoned, or at least significantly modified, his traditional opposition to softer bond markets. He inaugurated the Canadian money market. On the whole, however, he seems to have conceived his basic role as being one of contributing to the prevention of the kind of long run secular stagnation that so exercised economists during the immediate postwar period. The formula that the Bank of Canada adopted to attain this end was the conscious nonuse of most of its powers.[5] It strove to refrain from any move that might generate anxiety about the future, in the minds of entrepreneurs especially, while attempting at the same time to encourage the development of sophisticated credit facilities. Mr. Towers also displayed little visible desire to intervene in interinstitutional relationships within the financial sector: he seems to have preferred

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[5]This interpretation is endorsed by most writers on the subject. See, for example, E.P. Neufeld, Bank of Canada Operations and Policy, Toronto, University of Toronto Press, 1958, pp. 182-206.

instead a somewhat olympian detachment. His errors, such as they were during those years, were mainly ones of omission.

The second Governor, Mr. James E. Coyne, took office at a time when the Canadian economy was being subjected to an entirely different, and in many respects unprecedented, set of pressures. To the task of coping with them he brought a vision and a style that were no less singular. If Mr. Towers may be described as having believed, in Thoreauesque fashion, not only that that regulator regulates best who regulates least, but also that he should do so as unobstrusively as possible, then his successor may be said to have looked upon himself as a combination of Cassandra and Jeremiah. For Mr. Coyne, silence meant acquiescence and passivity meant complicity whenever Error was abroad. Throughout the greater part of his tenure Error stalked the land and beguiled its people. He therefore set himself to confronting it and correcting them.

This is not the appropriate place to chronicle Mr. Coyne's labours, except as necessary to convey the essential warp and woof of monetary policy in Canada between 1955 and 1961. That can be done quite briefly. Like his predecessor, he was haunted by a spectre; but in his case it was the spectre of inflation. It, like that of his predecessor, was thought to be endemic in the existing system, and was therefore unlikely to be susceptible to palliatives. But Mr. Towers during the postwar years was able, as we know, to regard most of the prevailing trends as at least fending-off, if not eliminating, what he feared above all else. No such solace was available to Mr. Coyne. He saw himself increasingly engulfed by tendencies that could only hasten the bitter harvest and make it worse than it might otherwise have been. Nor could he, as could his predecessor, console himself with the knowledge that there were kindred spirits in the chancelleries: what, after all, can a politician of Mr. Tower's day have dreaded more than chronic under-employment? For Mr. Coyne there must instead have been first the suspicion and later the certainty that the government of the day opposed his designs and hoped to successfully disavow his works.[6]

Finally, we have the apocalyptic nature of his vision. Lingering unemployment and related ills are painful to contemplate, to be sure, but at least they do not usually jeopardize the integrity of the afflicted society as national and moral entities. But when a country embarks, as Mr. Coyne considered Canada to have done through most of the 'fifties, on an investment "spree" of unparallelled proportions that was "premature, wasteful, speculative, and unproductive," with her consumers following suit; and when she garnishes these inflationary forces with large increases in her imports accompanied by massive foreign borrowing--then she inflicts upon herself economic injuries of a "chronic structural" nature; she imperils her "national independence;" and she addicts her

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[6]A vivid description of his thoughts and emotions can be found in his statement on the bill declaring vacant the position of Governor of the Bank of Canada. Canada, Senate, Proceedings in the Standing Committee on Banking and Commerce, July 10, 1961. The bill never became law, but Mr. Coyne resigned because his position had obviously become untenable.

citizens to perpetually "living beyond their means."[7] She courts, in a word, disaster, and at an accelerating tempo. Possessing a doughty temperament, feeling isolated from and embattled by his compatriots, and thinking himself alone in perceiving the tiger at the gates, it was inevitable that he should have deported himself as few central bankers have done, before or since. He stumped the country; he criticized his government, first obliquely but later more frontally; and he transformed his Annual Reports from objective factual recitals into forensic devices. Increasingly the evangelist rather than the technician, he attempted to manipulate not only the levers that central bankers traditionally control but also, with his rhetoric, those in the hands of investors and consumers. Because of the nature of his position everything he called for became part of what the Bank of Canada represented in the mind of the community. As a result, its reactions to him as a man merged with its reactions to the visible and imputed behaviour of the Bank. They became, in other words, part of the effects of monetary policy.

Mr. Coyne was succeeded in mid-1961, after his abrupt and sensational effective removal from office, by his Deputy, Mr. Louis Rasminsky. The occasion was a highly traumatic one for all Canadians, and it generated an atmosphere in which "the belief was widespread that

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[7]See David C. Smith and David W. Slater, "The Economic Policy Proposals of the Governor of the Bank of Canada," Queen's Quarterly, LXVIII, Spring, 1961 as well as H. Scott Gordon, The Economists Versus the Bank of Canada, Toronto, Ryerson Press, 1961.

financial policy was being grossly mismanaged, and that the Bank of Canada's recent interventions had aggravated the difficulties rather than relieved them."[8]

The Narrower Goals of the Bank of Canada

The Bank of Canada conceives of itself as being basically a member of the set of public institutions which exists to collectively promote such goals as sustained economic growth at high level of employment and efficiency, internal price stability, economic equity and economic freedom, and the like. It also feels that it has a particular responsibility for "seeing that adequate emphasis is at all times placed on price stability in the consideration of public policy," an objective that it does not consider incompatible with the others.[9]

[8] J.C. Weldon, "Fairer Competition for Canada's Banks," The Banker, CXIV, July, 1964, pp. 417-21.

[9] Submission: Bank of Canada, p. 5. This document appeared after many of the events covered by this study had occurred, and expresses the views of the successor to the man who personified monetary policy during most of the years under review. Mr. Rasminsky was, however, very close indeed to the heart of the decision-making machinery of the Bank throughout this period and it is reasonable to assume that, with the one exception noted below, those of his views quoted here reflect those held by the Bank's management during the 'fifties.

Its role is to work in the realm of "credit conditions", an area which embraces

> "...the whole range of terms and conditions affecting borrowing and lending and the purchase and sale of financial assets: the level and rates, and the various requirements (over and above the payment of a certain rate of interest) which lenders require of borrowers as a condition of making funds available, e.g., the specifications of standards of credit worthiness, collateral security, repayment period, etc."[10]

The Pivotal Role of the Chartered Banks; the Allocative Role of the Market

The Bank's role devolves technically from the fact that its principal liabilities, currency and commercial bank deposits, compose the foundations of the money supply. The second, and usually the smaller, of these liabilities constitutes also the cash reserves of the commercial banking system, and it is in their modification that the Bank's purposes are usually achieved. As the current Governor puts it:

> "With the chartered banks operating on the basis of reasonably stable cash ratios, variations in the supply of cash reserves would be expected to initiate a chain of institutional and market responses whose ultimate effects on the cost and availability of credit would be broadly in line with the central bank's objectives, although neither predictable nor controllable in detail."[11]

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[10] *Ibid.*, p. 119.

[11] *Ibid.*, p. 134. (Emphasis added.)

Since this study is to a large extent concerned with some of the links in this chain of institutional and market responses, Mr. Rasminsky's justification of the above approach is of considerable interest.

> "It would provide little control over the precise timing or detailed character of the resulting changes in interest rates and institutional lending and investment policies, but it would leave a great deal of leeway for the interplay of private decisions in working out the detailed pattern of interest rates, credit allocation, and the distribution of assets held by financial institutions and the public."[12]

In addition to its other consequences, this tends, incidentally, to render the Bank of Canada's other basic function, debt management, something of a residual. The general financial market, is thus "given as much freedom as possible, within the general environment influenced by the cash reserve management of the central bank, to place its own valuation on the securities issued by the government."[13] The alternative would allegedly require, in effect, the reversing of these priorities, and is generally to be avoided because

> "Changes in the market prices of Government securities would appear on the surface to be merely the result of central bank action and this would make it much more difficult for the central bank to follow a flexible monetary policy. Moreover, the attention of dealers and investors would tend to concentrate on anticipating the next move of the central bank,

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[12] Ibid., p. 135. (Emphasis added.)

[13] Ibid., p. 134.

> and continuous short-run speculation rather than appraisal of the underlying forces at work might well become the dominant activity in the Government securities market. The central bank would have a particularly difficult problem of coping with undesirable destabilizing shifts in market expectations <u>generated by its own actions</u>."[14]

<u>How Bank Reserves Were Computed between 1953 and 1962</u>

It is worth digressing briefly to describe the manner in which the chartered banks were required, during the decade under review, to comply with the reserve ratio set by the Bank of Canada. Before the Bank Act was revised in 1954, the banks were required to always maintain, in the form of Bank of Canada notes and deposits with the Bank of Canada, a minimum reserve of 5% of Canadian dollar deposits. (In practice they carried 10%.) The revised Act obliged each bank to carry a minimum monthly average cash reserve of 8% of its deposit liabilities. There were, again, three component parts: total deposit liabilities, note holdings, and deposits at the central bank. The Act further stipulated that reserves be computed by taking the average deposit liabilities and note holdings of the four consecutive Wednesdays ending with the second last Wednesday of the previous month. For the deposits with the Bank of Canada an average of the daily totals for the current month was to be used. Thus, for any

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[14] <u>Ibid</u>., p. 135. (Emphasis added.)

given month, it was only the third of the above elements that was variable, the others being fixed. Hence, changes in a chartered bank's deposit liabilities or note holdings, whether brought about by monetary policy or otherwise, had no effect on its legal responsibilities until the following month.[15]

The Bank of Canada's Attitude towards Near-banks, in Relation to Monetary Policy and as Competitors of the Chartered Banks

The foregoing, to resume the main argument, clearly demonstrates that the Bank of Canada regards the chartered banks as the basic instrument through which to execute its general purposes of any given moment, leaving it to the market to work out the ramifications in detail. It is of course aware that other financial institutions exist, but regards them as having largely different functions from those of the banks, although it recognizes that similarities also exist.[16] This tends to make them collectively a thing apart from the chartered banks, as far as monetary policy is concerned. As to whether anti-inflationary monetary policy has generally suffered as a result, the Governor states that

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[15] *Ibid.*, p. 39. It should also be mentioned that since late-1955 the chartered banks voluntarily carried a secondary reserve amounting to 7% of total deposit liabilities in the form of highly liquid government securities.

[16] *Ibid.*, p. 123.

> "The rapid growth during recent years of various types of financial institutions which compete directly with the chartered banks in various aspects of their lending and deposit business raises a number of important questions..., /one/ question is whether the operations of these institutions which are not subject to stipulated cash reserve or liquid asset requirements have constituted in practice a serious impediment to the effectiveness of a policy of monetary restraint in Canada on the occasions when this has been the aim of the central bank. My own feeling with regard to this important issue is that they have not...."[17]

The above statement is quite correct as to the Bank's general attitude towards near-banks during the 'fifties, but is subject to one important exception. There was in fact, as will be shown below, one group of financial institutions that the Bank regarded as a serious impediment to restrictive monetary policy--the sales finance industry.

The next questions to be considered are whether the growth of the near-banks has, in the Bank's view, taken place at the expense of the banks, and whether this development is due, as Gurley and Shaw have suggested, to the fact that only banks are subjected to reserve ratios and other legal restraints. Here, too, the Governor is explicit, and, again, there is a significant exception to be noted.

> "The ability of the so-called "near-banks" to grow at the expense of the chartered banks seems to me to depend basically on the ability of the "near-banks" to offer relatively more attractive terms to those with funds to deposit or invest than are offered by the chartered

[17] Ibid., p. 9. (Emphasis added.)

banks.... If the chartered banks were able and willing to maintain their deposit rates at competitive levels and recoup themselves by raising their lending rates, I do not see why their membership in the fractional cash reserve system should prevent them from growing as rapidly as their competitors who are not members....

"In practice, of course, the chartered banks are restricted in the lending rates they can charge and in their participation in certain remunerative fields of lending, and this undoubtedly affects their ability to compete for funds by offering sufficiently attractive interest rates on time and notice deposits. I should imagine that this is one of the main reasons why the chartered banks have lost ground to their near-bank competitors during the past decade. <u>On the other hand, I do not think that there is much evidence that the competitive gains of the "near-banks" at the expense of the chartered banks have been unusually great during periods of monetary restraint except in certain rather special cases, such as the gains made by the instalment finance companies in the field of personal lending during the early 1950's, before the general move of the chartered banks into the field of instalment-type personal loan plans.</u>"[18]

<u>Summary and Conclusions of Chapter II</u>

The first two sections of this chapter dealt with the strategic objectives of the Canadian monetary authorities from the end of World War II until the beginning of the 'sixties. They also conveyed what might be termed the tone of the monetary climate during that period. We saw that the management of the Bank of Canada, personified by the

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[18] *Ibid.*, pp. 9-10. (Emphasis added.)

Governor, was beset by an almost obsessive fear of inflation, and waged a vigourous and at times single-handed crusade against it.

We also noted that the Bank rejected the Gurley-Shaw thesis in its generalized form, and continued to use chartered bank reserves as its main policy lever. It was suggested, however, that the Bank did accept the Gurley-Shaw thesis with respect to one nonbank intermediary, the sales finance industry. This will be substantiated in Chapter IV.

The foregoing discussion also indicated that the Bank regarded the relative growth of the sales finance industry during the mid-fifties, when restrictive monetary policies were being pursued, as not only obstructive to its policies but also inequitable to the banks. This latter situation, however, was allegedly rectified later, when the banks entered the sales finance field on a substantial scale.

CHAPTER III

ON THE ECONOMIC EFFECTS OF COMMODITY INSTALMENT CREDIT

Why Borrowers Borrow

Sales finance companies have as their basic raison d'être the provision of commodity instalment credit. As the term implies, debtors are required to apply the borrowed funds to the acquisition of specific commodities and to make fractional repayments according to explicit, predetermined schedules. It is now appropriate to examine the economic character of the representative user of commodity instalment credit together with some conceptual considerations to which his activity gives rise.

He of course shares with all borrowers the characteristic of wishing to make a current payment but lacking the necessary liquidity. The fact, however, that the payment he has in mind is one for which he will receive in return a durable good, combined with his willingness to regularly transfer, as repayment, segments of his anticipated future inflows of funds, distinguishes him from the others. Were this or an equivalent type of credit not available, he would either have to forego the acquisition of the good in question until such time as he succeeded in accumulating the wherewithal from his income flow, or liquidate some previously-acquired asset. (Given the availability of commodity instalment credit of varying repayment intervals, it may be inferred that the interval he chooses corresponds roughly to that which would otherwise elapse before he could accumulate the necessary savings.)[1] Naturally, there are costs involved in each of these alternative courses of action, and the rational borrower will presumably try to maximize his total well-being by equating at the margin the relevant costs and benefits, and thereby determine the total use he will make of this type of credit.

Hypothetical Effects of Commodity Instalment Credit on the Level of Aggregate Demand

Our ultimate concern is with the overall relationship between commodity instalment credit and the level of aggregate spending on current output, as both variables move through the successive phases of the business cycle. It seems a reasonable procedure, however, to approach that relationship by first considering the impact of commodity instalment credit on the current level of aggregate demand. Then the discussion will be extended to its impact on the stability of the economy.

There is, to begin with, no single, general answer to the question of whether the extension of commodity instalment credit will increase the

[1]Disregarding the size of the down-payment and the rate of interest.

borrowers' current demand for the goods specifically involved, because we can never say with certainty that, in its absence, they would have chosen to forego those goods until some later date. Still less can we generalize as to the effects on current demand for goods in the aggregate. In this respect the main difficulty lies in our uncertainty as to what the various suppliers of credit would otherwise have done with the funds involved. The situation becomes even more indeterminate in the abstract when repayments are considered. Now it becomes necessary to know not only how the debtor-repayer would have used his funds if he had not had to make repayments but also how the successive creditor-collectors will use them thereafter. Clearly, then, we can attribute to a given change in the level of outstanding commodity instalment credit radically different consequences for the aggregate level of demand, merely by making appropriate assumptions about the foregoing considerations.

A certain amount of empirical evidence is available relating to the first set of uncertainties,[2] and it together with certain assumptions that appear reasonable will be used as our basis for further analysis. The spread between the return on liquid assets and the contemporaneous cost of commodity instalment credit is so large[3] that

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[2]Concisely summarized in the following volume: Paul W. McCracken, James C.T. Mao, and Cedric V. Fricke, Consumer Instalment Credit and Public Policy, Michigan Business Studies, Vol. XVII, No. 1, The University of Michigan, Ann Arbor, Michigan, 1965. The data refer to U.S. experience, but they are probably consistent with those pertaining to Canadian experience.

[3]*Ibid.*, pp. 23-24. It is estimated as being at least 8% per annum.

it seems unlikely that the average credit user would borrow in this fashion if he possessed liquid assets of corresponding value. This implies that the financed commodity would probably not otherwise have been acquired and, therefore, that the incurring of the liability by the borrower represents an increase in his total current demand.[4]

The next question, concerning the level of aggregate demand, depends on what the supplier of the credit would otherwise have done with his money. This depends, in turn, on a more fundamental question. To put it into perspective, consider that the sales finance company (which is the major but, as we will see later, by no means the only, Canadian supplier of this type of credit), derives its loanable funds mainly from two sources: the banks and other nonbank intermediaries. It is therefore necessary to know, really, what they would have done with the money if they had not purchased sales finance company liabilities. The answer to that question depends basically on the overall level of business activity. In relatively slack times it is likely that these funds would otherwise constitute excess lending capacity, but in boom periods they would probably be diversions from other types of lending. These, being quite variegated, do not have the direct links with the acquisition of goods that commodity instalment credit does. It is therefore difficult to say to what extent aggregate demand is reduced by the diversions, except that any such reduction is

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[4]The borrower way, of course, be either a private consumer or an entrepreneur. If he is a consumer then it is demand for consumer goods that increases. If he is an entrepreneur investment demand rises.

bound to be less than the increase in aggregate demand occasioned by the associated extensions of commodity instalment credit. (That there will generally be a concurrent expansion of outstanding commodity instalment credit when sales finance companies borrow is, at least, fairly certain, both in the abstract and, as will be seen below, on the basis of actual experience: there would otherwise be little reason for them to incur the interest costs involved.) On balance, therefore, it seems reasonable to suggest that an increase in the level of outstanding commodity instalment credit will result in a lesser rise in the level of current aggregate demand, its magnitude varying inversely with the volume of economic activity.

We can similarly assert, with respect to repayments, that whenever sales finance companies contract their total outstandings (i.e., when repayments exceed extensions of new credit) they will correspondingly reduce their current indebtedness to their own creditors. It therefore follows that the effects of contractions on aggregate demand depend jointly on the uses that the debtor-repayers would otherwise have made of the money and how the banks and other creditors of sales finance companies will subsequently dispose of it. Assuming that the repayments generally come from the income inflow of the debtor, this means that they will reduce, in some proportion, both his current consumption spending and his current saving. It has been suggested that personal saving has become increasingly contractual; that individuals commit themselves increasingly to saving forms such as insurance and pension plans which require periodic (e.g., monthly) contributions. This implies that a decreasing portion of their income will be available for discretionary consumption and saving, and, therefore, that the lion's share of debt repayments come out of current consumption spending.[5] Another tendency that supports this expectation is the increasing substitution of the services provided by <u>ownership</u> of the durable goods (e.g., motor vehicles) that sales finance credit makes possible for their separate purchase (e.g., transportation) from firms. Hence, it is suggested, repayments constitute substitutes for the consumption expenditures that would otherwise be necessary.[6] (On the other hand, the very ownership of such goods could conceivably inspire changes in individuals' behaviour patterns that would require increased consumption expenditures. For example, the possession of an automobile might lead to longer or more frequent excursions for holiday or entertainment purposes.)

The hypothetical reasoning as to the subsequent uses that the banks and other lenders to sales finance companies are likely to make of the funds made available by contractions in total outstandings is analogous to that concerning expansions. This means, in effect, that under boom conditions repayments will tend to be reloaned, more or less immediately, but when the economy is in recession they are likely to increase the idle lending capacity of the institutions involved. An

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[5]McCracken, Mao, and Fricke, <u>op. cit</u>., pp. 25-26.

[6]<u>Ibid</u>.

extension of commodity instalment credit does not by any means necessarily involve the acquisition of a currently-produced commodity. A very considerable proportion of sales finance company loans covers purchases of used goods, especially automobiles. Even when the transaction involves a new article there is always the possibility that it was produced during the preceding fiscal year. In order to gauge the effects of the transaction on aggregate demand we would therefore need to know something about the seller's inventory policies. When a loan covers the purchase of a used vehicle only that part of its price which represents dealer services and the like constitutes income during the current period, the remainder represents a transfer of assets. However, the seller of the vehicle to the dealer, having liquidated an asset is now in a position to buy other goods. It is, indeed, highly probable that this was the very consideration which prompted the sale. There is therefore a strong presumption that that transaction was immediately or shortly thereafter followed by further expenditures on goods and services.

Before going on to other economic implications of the extension of commodity instalment credit, it should be noted that even if the level of aggregate demand were to remain, under boom conditions, at around the same level as it would otherwise have been, because of the abovementioned offsetting effects, this would not mean that the state of the economy was unaffected. Quite apart from all other considerations, the extension of commodity instalment credit during boom times has the effect of diverting resources into the production of consumer durables and away from other areas--the production of other, more durable, capital goods, for example. In other words, in addition to whatever impact sales financing may have on the <u>size</u> of the economy's total output it also has a significant effect on its <u>composition</u>. This, too, is a matter in which the monetary authorities may claim a legitimate interest, as, indeed, the Bank of Canada did on at least one occasion during the 'fifties.

<u>Some Multiplier-accelerator Considerations</u>

Extensions of commodity instalment credit generate certain multiplier-accelerator effects. So, together with all factors affecting the level of aggregate demand, do other types of credit, but their effects are, with one exception, basically different in character.[7] Instalment credit is unique in its repayments mechanism. The basic nature of the operative factors can be conveyed by means of the following example, which rests on some simple assumptions.

Consider a model[8] in which all commodity instalment loans finance the acquisition of consumer durables that have been produced by firms operating in an economy which employs only labour. (There is therefore

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[7]The exception is the category of cash loans subject to repayment by instalment. Here, however, the borrower is free to spend the money as he sees fit. Sales finance companies, operating through affiliates, also engage in this kind of lending on a very substantial scale.

[8]Based on a model in McCracken, Mao, and Fricke, <u>op. cit.</u>, pp. 31-33.

no inherent accelerator potential.) Every individual in this economy makes current consumption expenditures only on currently-produced goods,[9] out of his earnings of the previous period only, and is subject to a constant marginal propensity to consume of 60%. Instalment repayments are made entirely at the expense of current consumption. All loans are for a ten-period repayment interval beginning in the first period following their extension. They are also interest free.

Under the assumptions made, and excluding the abovementioned offsetting effects, the direct impact of the instalment lending on spending for current output is equal to the difference between current loans extended and current repayments. Table III-1 shows that when the level of current extensions is held constant this effect falls by a constant absolute amount for the first ten periods and then settles at zero. This is the root reason why the "indirect effect", equal to 60% of the total incremental change of the previous period, also starts declining by the sixth period. The combined effect is to cause the total incremental change to begin falling earlier, by the fifth period, and to dwindle to insignificance within approximately twelve periods.

This rudimentary mechanism is intended to focus attention on the fundamental importance of changes in the level of new loans extended to the total incremental change in the level of spending in the current and immediately following periods. It is, however, only in those relatively

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[9]This requirement could be dropped if it were assumed that sellers are committed to maintain a certain constant physical inventory.

TABLE III-1

HYPOTHETICAL ILLUSTRATION OF INCREMENTAL EFFECT ON NATIONAL INCOME OF CHANGES IN INSTALMENT CREDIT OUTSTANDING

Period	Extensions	Repayments	Change in Amount Outstanding	Indirect Effect	Incremental
1	$1,000	$ ...	$1,000	$ ...	$1,000
2	1,000	100	900	600	1,500
3	1,000	200	800	900	1,700
4	1,000	300	700	1,020	1,720
5	1,000	400	600	1,032	1,632
6	1,000	500	500	978	1,478
7	1,000	600	400	887	1,287
8	1,000	700	300	773	1,073
9	1,000	800	200	644	844
10	1,000	900	100	506	606
11	1,000	1,000	...	364	364
12	1,000	1,000	...	218	218
13	1,000	1,000	...	131	131
14	1,000	1,000	...	78	78
15	1,000	1,000	...	47	47
16	1,000	1,000	...	24	24
17	1,000	1,000	...	14	14
18	1,000	1,000	...	8	8
19	1,000	1,000	...	5	5
20	1,000	1,000	...	3	3

Source: McCracken, Mao, and Fricke, op. cit.

few periods that these changes have significant effects. Because repayments begin immediately, the reverberations shrink to insignificant proportions faster than those caused by most other increases in aggregate demand. This peculiarity of instalment credit is especially apparent when, as in this case, only one period, the first, experiences a change in the volume of loans extended. It is further underscored on Table III-2, in a way that is somewhat less unrealistic. The foregoing assumptions are maintained, but applied to levels of outstanding consumer instalment credit that actually prevailed in the U.S. from mid-1954 to the end of 1962.[10]

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[10] An interesting result was noted by the writers who conceived this model (McCracken, Mao, and Fricke, op. cit., pp. 34-36), when the dates of the changes from peak to trough in the 1958 and 1960 recessions in the U.S. were imposed on the figures of Table III-2. In both cases the low point in total incremental change in spending was reached one period after the trough. This lends credence to the Bank of Canada's claim, to be quoted more fully below, that commodity instalment credit tends to operate as a drag on the timing, and also on the extent, of economic recovery. On the other hand, the observed shortness of the interval during which the upward movements in outstandings exerted strong pressures on the total incremental change in spending raises a question as to whether this buoyancy continued past the full-employment level of output, and thereby contributed to inflation, especially when offsetting effects are considered. About the most that can be said, in terms of this model, is that the recovery, though somewhat belated, was boosted strongly at its outset. That effect, if it were a general one, could indeed cause total spending to peak somewhat higher and later than it otherwise would, but, again, it does not necessarily involve pushing the economy into inflation. We will consider this matter further below, within the context of Canadian experience.

TABLE III-2

HYPOTHETICAL ESTIMATE OF INCREMENTAL EFFECT ON NATIONAL INCOME OF CHANGES IN CONSUMER INSTALMENT CREDIT OUTSTANDING, 1954-62
(in millions of dollars)

Year	Quarter	Change in Amount Outstanding	Indirect Effect	Total Incremental Change
1954	3	155	0	155
	4	554	93	647
1955	1	1,309	388.2	1,697.2
	2	1,461	1,018.3	2,479.3
	3	1,459	1,487.6	2,946.6
	4	1,030	1,768.0	2,798.0
1956	1	955	1,678.8	2,633.8
	2	630	1,580.3	2,210.3
	3	504	1,325.5	1,829.5
	4	684	1,097.7	1,781.7
1957	1	530	1,069.0	1,599.0
	2	604	959.4	1,563.4
	3	554	938.1	1,492.1
	4	403	895.2	1,298.2
1958	1	-341	778.9	437.9
	2	-301	332.5	31.5
	3	-98	-23.0*	-121.0
	4	505	-72.8	432.2
1959	1	1,130	259.0	1,389.0
	2	1,387	832.9	2,219.9
	3	1,713	1,331.6	3,044.6
	4	1,263	1,826.4	3,089.4
1960	1	1,239	1,853.4	3,092.4
	2	1,134	1,855.3	2,989.2
	3	720	1,793.4	2,513.4
	4	452	1,507.8	1,959.8
1961	1	-99	1,175.8	1,076.8
	2	-95	645.9	550.9
	3	2	330.3	332.3
	4	745	199.3	944.3
1962	1	720	566.7	1,286.7
	2	1,353	772.1	2,125.1
	3	946	1,275.1	2,221.1
	4	1,423	1,332.5	2,755.5

* The sign of this item should be reversed, and the amount should be 18.9. Since the consequences of this, and one or two other very minor numerical errors in the Source, are negligible, as far as the argument here is concerned, it has not seemed necessary to recompute the columns affected.

Source: McCracken, Mao, and Fricke, op. cit.

This model, of course, is a gross oversimplification of reality. For one thing, accelerator effects were excluded. Yet, when we consider the matter further its possible relevance to reality is not necessarily undermined. General multiplier-accelerator effects vary according to a number of factors, including among others the economy's aggregate capital-output ratio, the trend of its aggregate marginal propensity to consume, the existence of excess-capacity in both the consumer goods and producer goods sectors, and the lengths of the relevant lags. At different times and under different conditions these are capable of assuming a quite wide variety of values, and thus no easy generalization is possible. But if it is true, as several writers have implied,[11] that historical experience may indicate a much weaker and briefer potential for volatility in the real-world mechanism than can easily be conceived of theoretically, then its exclusion may not constitute a conceptual distortion of fundamental importance. Also, as was just suggested by McCracken, Mao, and Fricke, the net extension of instalment credit may produce its most expansionary consequences immediately after the upswing has got under way. That will usually be an occasion when considerable excess-capacity exists in the economy, and therefore the accelerator effects will probably be slight. This creates the likelihood that the offsetting effects that the extension of instalment credit has on the

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[11]See for example, Paul A. Samuelson, "Interaction between the Multiplier Analysis and the Principle of Acceleration," Review of Economic Statistics, XXI, May, 1939, pp. 75-78, and R.S. Eckaus, "The Acceleration Principle Reconsidered," Quarterly Journal of Economics, LXVII, May, 1953, pp. 211-21.

availability of other forms of credit are at their weakest under precisely these conditions and at their strongest when the expansion of outstandings has either petered-out or is about to do so. These offsetting effects have demand (and therefore multiplier-accelerator) consequences of their own and it is probable that these will be at their strongest when the economy is closer to the full-employment mark than when it is further away from it.

The above considerations thus imply that there exist substantial grounds for uncertainty as to commodity instalment credit's inflationary, as opposed to merely expansionary, capabilities. They produce, more specifically, a plausible hypothetical basis for expecting that its main impact on total spending will be to delay but strengthen the earlier phases of a general rise in the level of output. Again, however, it should be emphasized that this does not mean that it cannot have significant effects on total spending during other phases of the business cycle as well as on the qualitative composition of total output.

The Volatility of the Demand for Consumer Durables

There is, however, still another dimension of the potential impact of commodity instalment credit on the stability of the economy that must be considered. Its effects on total spending, discussed above, are broad ones. They must first filter through the industries that produce the specific commodities whose acquisition it finances. Hence the response of those industries to the initial impact of increased demand is quite significant. Automobiles and the other consumer goods involved are rather durable articles, which normally depreciate physically at a fairly predeterminate rate. Nevertheless, their output, especially that of automobiles, is subject to a kind of inherent instability to which that of other commodities, of which services are the purest example, is immune. The predictability of the physical rate of depreciation would, of course, be in itself a factor making for stability. It would help producers to anticipate that portion of current demand which represents the desire of past purchasers to replace the automobiles, etc. that they already possess. If new purchasers were willing to so arrange their activity as to enable producers to accomodate them in an orderly fashion, spread-out evenly over time, no great volatility would probably ensue. The same would then also be true of another potentially volatile element in the overall situation, the fact that the production functions involved are relatively capital-intensive. In these circumstances investment could probably be planned and executed quite smoothly.

In reality, however, this sort of smoothness is seldom possible. Consumer durables, especially automobiles, perform in our society functions that are sociological and aesthetic as well as merely technical. This renders the demands for them distinctly sensitive to such essentially psychological forces as style changes and the like. Consumers' responses to these are difficult to anticipate, and thus the actual replacement rate is less predictable than it would be if it depended only on physical attrition. Historical experience indicates that there does exist a definite tendency for people to cluster both their initial acquisitions (when they marry and set up housekeeping, etc.), and their subsequent replacements of household goods. Past levels of automobile demand have been even more uneven. The consequences, as Table III-3 illustrates hypothetically, can be considerable. All automobiles are assumed thereon to have a life of ten years, and in part A new demand is constant at .5 million units per year for the first ten years, while in part B the entire increase of 5 million units occurs in year one. This bunching of new demand in part B doubles total output in year one and year eleven over the preceding years while halving it in the following ones. (Corresponding fluctuations in the capital goods industries can also be postulated plausibly.) Those who assert that this sort of unevenness is indeed inherent in our economy usually define the rate of change in the level of demand for automobiles as a function of the rate of change in the level of income. They also assign to instalment credit a particular role in this process. As one such writer explains:

> "The destabilizing effect...is undoubtedly intensified in the downward direction by the fact that replacement can be postponed beyond the normal time and in the upward direction by the availability of...credit which permits rapid expansion of purchases to make up for postponement of replacement during the downswing...."[12]

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[12] Warren L. Smith, "The Effects of Monetary Policy on the Major Sectors of the Economy," in L.S. Ritter (ed.), <u>op. cit</u>., pp. 189-90.

TABLE III-3

THE EFFECT OF "BUNCHING" OF OUTPUT ON THE STABILITY OF THE AUTOMOBILE INDUSTRY

A. NO BUNCHING
(in millions of physical units)

Period	0	1	2	3	4	5	6	7	8	9	10	11	12	....	21
Replacement	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.5	5.5	....	5.5
New Demand	0.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.0	0.0	....	0.0
Total Output	5.0	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	....	5.5
Total Stock	50.0	50.5	51.0	51.5	52.0	52.5	53.0	53.5	54.0	54.5	55.0	55.0	55.0		55.0

B. BUNCHING
(in millions of physical units)

Period	0	1	2	3	4	5	6	7	8	9	10	11	12	....	21
Replacement	5	5	5	5	5	5	5	5	5	5	5	10	5	....	10
New Demand	0	5	0	0	0	0	0	0	0	0	0	0	0	....	0
Total Output	5	10	5	5	5	5	5	5	5	5	5	10	5		10
Total Stock	50	55	55	55	55	55	55	55	55	55	55	55	55		55

Source: McCracken, Mao, and Fricke, op. cit.

The clear implication of the foregoing is that commodity instalment credit, which is an agent and not a cause of this variability, may in theory and, as Canadian experience during the 'fifties suggests, in fact be associated with a substantial degree of economic fluctuation.

Summary and Conclusions of Chapter III

It is not possible to state categorically, in the abstract, how the various borrowers and lenders that the mechanism of commodity instalment credit links together would have exercised their options if the mechanism did not exist. Nevertheless, there are plausible grounds for attributing the following economic effects to this type of credit. Its extension increases the borrower's current level of demand, and his repayments reduce his level of demand in subsequent periods. This makes changes in total outstandings a reliable indicator of the effects of commodity instalment credit on the debtors involved. As to its effects on the levels of aggregate demand and spending, these depend basically on the level of general economic activity. They will be greatest during slack times, when the financial sector has excess lending capacity, but they may also be significant during boom times. In addition to its quantitative impact on aggregate demand commodity instalment credit also materially affects its composition, thus giving consumer durables a relatively greater share of total output than they would otherwise have.

Its effects on the level of total spending are governed primarily by a multiplier mechanism, modified by the fractional repayment arrangements peculiar to it. This suggests that the most significant expansions in total spending associated with a given increase in total outstandings will occur during the first few spending periods following the increase. (The possibility also arises, to be investigated further in the next chapter, that its quantitative effects are greatest just after total spending has passed its trough and has begun to rise.)

Demand for consumer durables, especially automobiles, is notoriously volatile. Thus, commodity instalment credit, acting as a *deus ex machina*, is also capable of contributing significantly to fluctuations in total spending by facilitating recurring fluctuations in the output of these goods.

CHAPTER IV

THE ECONOMIC IMPACT OF THE CANADIAN SALES FINANCE INDUSTRY; 1953-1962

The Cyclical Behaviour of the Canadian Sales Finance Industry; 1953-1962

In identifying the general turning points of the level of overall economic activity in Canada during the years under review we rely, as do other writers on analogous phenomena, on the reference cycle dates determined by Dr. D.J. Daly.[1] These are as follows:

June, 1954	Trough
April, 1957	Peak
April, 1958	Trough
January, 1960	Peak
March, 1961	Trough

The data refer to the "ten largest companies" group described elsewhere, which may be taken as being synonymous with the sales finance industry.

Table IV-1 shows that the industry's total outstandings varied consistently in a strongly procyclical fashion and, as Mr. Coyne implied and the earlier hypothetical discussion indicated they would, they

[1] H.G. Johnson and J.W.L. Winder, Lags in the Effects of Monetary Policy in Canada, A working paper for the Royal Commission on Banking and Finance, Ottawa, Queen's Printer, 1962, p. 22.

TABLE IV-1

CYCLICAL TURNING POINTS AND AMPLITUDES IN TOTAL NOTES RECEIVABLE OF THE TEN LARGEST SALES FINANCE COMPANIES AND REFERENCE DATES FOR CANADA, 1953-1961

	Reference Date	Turning Point Total Notes Receivable	Lag (No. of (Quarters) Total Notes Receivable Behind Reference Date	Total Notes Receivable Seasonally Adjusted (millions of dollars)	Per Cent Change-Trough to Peak and Peak to Trough
Trough	II / 1954	IV / 1954	(2)	737	
Peak	I / 1957	III / 1957	(2)	1,210	+64.2
Trough	II / 1958	III / 1958	(1)	1,118	- 7.6
Peak	I / 1960	IV / 1960	(3)	1,372	+22.7
Trough	I / 1961	IV / 1961[a]	(3)	1,284	- 6.4

[a] Turning point not established: series shows decline at latest figure for IV / 1961.

Source: Federated Council of Sales Finance Companies.

turned upward and downward after the level of economic activity did. It is worthwhile to look also at the cyclical turning points of the main constituents of the industry's lending operations, since they are not identical with one another, and because these constituents have been evolving during the years under review. Table IV-2 shows the dates of the turning points of loans extended on new cars and total sales of passenger cars. It indicates that the troughs of loans on new cars lagged behind those of the level of economic activity on each of the three occasions, but that the peak of the former lagged behind that of the latter on one occasion and led it on the other. (It also indicates that these turning points have a certain tendency to lag behind those of sales of new passenger cars.) The turning points in the level of loans on used cars and other consumer goods are shown on Table IV-3. It is interesting that all three troughs of loans on used cars lagged behind those of the reference cycles but that there was a lead between both of their respective peaks. Table IV-4 gives the amplitudes of each of these cyclical swings.

The relative brevity of the overall interval imposes a degree of tentativeness upon any generalized statement of the cyclical character of sales finance lending in Canada. It is therefore useful to refer briefly to evidence of essentially similar patterns traced by commodity instalment credit in the U.S. during most of the past three decades. The peaks and troughs of the reference cycles are analytically analogous

TABLE IV-2

CYCLICAL TURNING POINTS IN NEW AUTOMOBILE RETAIL PAPER PURCHASED BY THE TEN LARGEST SALES FINANCE COMPANIES TOTAL SALES OF NEW PASSENGER VEHICLES AND REFERENCE DATES FOR CANADA, 1953-1961

	Reference Date	Total Sales of New Passenger Vehicles	New Automobile Retail Paper Purchased	No. of Quarters Lead (or Lag) New Automobile Retail Paper Compared to:	
				Reference Date	Total Sales of New Passenger Vehicles
Trough	II / 1954	IV / 1954	IV / 1954	(2)	0
Peak	I / 1957	II / 1956	III / 1956	2	(1)
Trough	II / 1958	IV / 1957	III / 1958	(1)	(3)
Peak	I / 1960	II / 1960	II / 1960	(1)	0
Trough	I / 1961	I / 1961	II / 1961	(1)	(1)

Source: Federated Council of Sales Finance Companies.

TABLE IV-3

CYCLICAL TURNING POINTS IN USED AUTOMOBILE PAPER AND OTHER CONSUMER GOODS INSTALMENT PAPER PURCHASED BY THE TEN LARGEST SALES FINANCE COMPANIES AND REFERENCE DATES FOR CANADA, 1953-1961

	Reference Date	Used Automobile Paper Purchased	Other Consumer Goods Paper Purchased	No. of Quarters Lead (or Lag) Compared to Reference Date:	
				Used Auto Paper	Other Consumer Goods Paper
Trough	II / 1954	IV / 1954	II / 1954	(2)	-
Peak	I / 1957	IV / 1956	II / 1956	1	3
Trough	II / 1958	IV / 1958	I / 1959	(2)	(3)
Peak	I / 1960	IV / 1959	IV / 1959	1	1
Trough	I / 1961	IV / 1961[a]	IV / 1961[a]	(3)	(3)

[a] Turning point not established: series shows decline at latest figure for IV / 1961.

Source: Federated Council of Sales Finance Companies.

TABLE IV-4

AMPLITUDES OF RETAIL CONSUMER PAPER PURCHASED
BY THE TEN LARGEST SALES FINANCE
COMPANIES, 1953-1961
(millions of dollars)

Annual Rates (Seasonally Adjusted) at Turning Points

	New Auto	Used Auto	Other Consumer Goods
Trough	247.8/ IV-1954	258.4/IV-1954	85.6/II-1954
Peak	498.4/III-1956	330.4/IV-1956	140.4/II-1956
Trough	345.2/III-1958	279.6/IV-1958	123.2/ I-1959
Peak	446.8/ II-1960	313.2/IV-1959	148.4/IV-1959
Trough	368.4/ II-1961	205.6/IV-1961	116.0/IV-1961

	New Auto	Used Auto	Other Consumer Goods
Trough to Peak	+101.1	+27.9	+64.0
Peak to Trough	- 30.7	-15.4	-12.2
Trough to Peak	+ 29.4	+12.0	+20.5
Peak to Trough	- 17.5	-34.4	-21.8

Source: Federated Council of Sales Finance Companies.

to those used above in relation to the Canadian economy, and the intervals covered are 1929 to 1940 and 1948 to 1962.

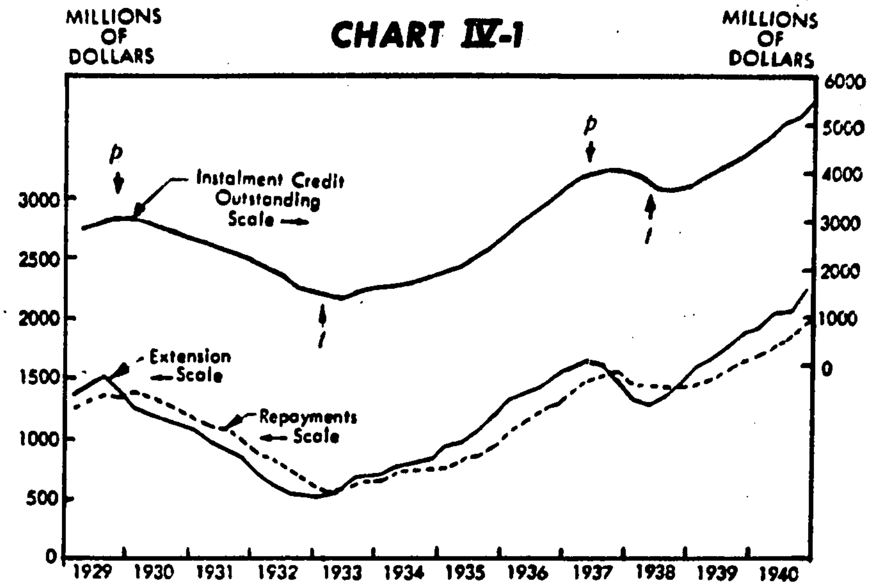
Chart IV-1 concerns the first interval, and shows that the turning points of total outstandings consistently lagged behind those of the general level of economic activity. Chart IV-2, which deals with the second interval, tells a rather more complicated but still similar story (quite apart from the references to Regulation W that relate to the question of regulation of commodity instalment credit, which will be taken up below). Again we observe the same general tendency for the peaks and troughs of total outstandings to lag behind those of the reference cycle.

The Behaviour of the Industry Compared with that of Other Canadian Financial Institutions; 1953-1962, as Seen by the Royal Commission on Banking and Finance

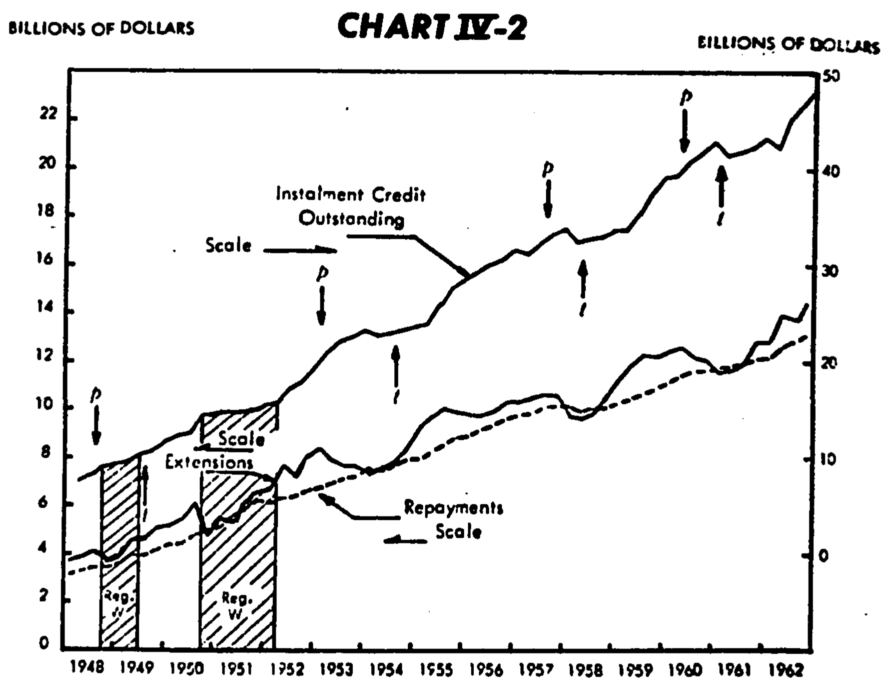
The Royal Commission on Banking and Finance explored the question of how fluctuations in the operations of the sales finance industry compared with those of other financial intermediaries in this country. Procedurally, the Commission first selected a specific criterion for each of the seven important Canadian financial intermediaries as being an appropriate indicator of that institution's evolution.[2] Next, it

[2] The following seasonally-adjusted quarterly series were used:
Chartered banks: currency and total deposits.
Quebec savings banks: total deposits.
Mortgage loan companies: deposits and debentures of four

U.S. EXPERIENCE



SOURCE: McCRACKEN, MAO, AND FRICKE, OP. CIT.



SOURCE: McCRACKEN, MAO, AND FRICKE, OP. CIT.

estimated the long-term trend of each indicator, and then computed the percentage of each observed value of the indicator series of the trend value at the same date. By so expressing the respective indicators the Commission sought to depict their cyclical movements. The results are given by Chart IV-3, and the Commission summed them up in the following way.

> "The...behaviour of all institutions <u>but the sales finance and small loan companies</u> has been broadly similar. In periods of restraint such as 1955-57 and 1959 their rates of growth have fallen sharply when the central bank has brought pressure to bear on the system's cash reserves and interest rates have risen. Similarly, they all tend to expand rapidly at the same time, as in 1954-55 and 1958. On the other hand, the assets of sales finance and consumer loan companies have grown more rapidly than usual in years such as 1956 and 1959 when interest rates were high and the total resources of the other institutions were under pressure, and have grown less rapidly or declined in periods of easier money."[3]

By way of explanation of this tendency, the Commission echoes the views of the Bank of Canada regarding the interest-inelasticity of the demand for sales finance company facilities.[4] But, unlike the Bank,

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companies.
Trust companies: deposits and certificates of eleven companies.
Caisses Populaires: deposits.
Sales finance companies: loans receivable.
Small loan companies: loans receivable.

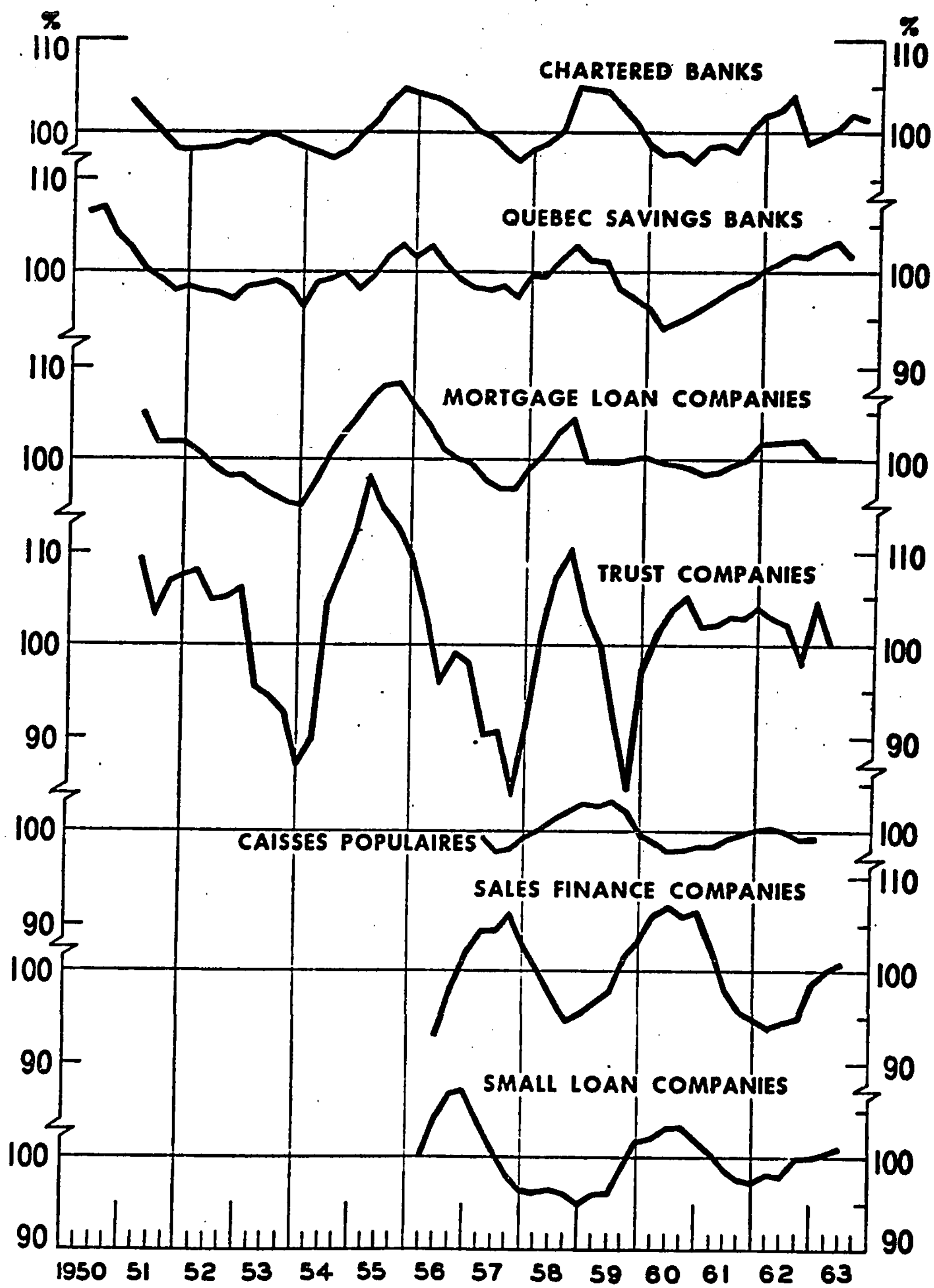
[3] <u>Report</u>, p. 219. (Emphasis added.)

[4] <u>Ibid</u>.

CHART IV - 3

CANADIAN FINANCIAL INSTITUTIONS : CYCLICAL FLUCTUATIONS

PER CENT OF TREND
QUARTERLY



Source : REPORT OF THE ROYAL COMMISSION ON BANKING AND FINANCE it places a quite different normative interpretation on the situation. This is worth noting because it relates to one of the basic questions involved in this study.

> "This, of course, is how a price system should work. The cyclical behaviour of the liabilities of sales finance and consumer loan companies shows that funds do flow to the borrowers willing to pay most for them, particularly when rates are high and funds are limited. Thus, the fact that lending by sales finance and consumer loan companies rose in the tight credit conditions of 1956-57 and 1959 is not evidence of a failure in the workings of general monetary policy but of an appropriate response to market forces."[5]

This approach to events tends to affirm the supremacy of the market mechanism over the sort of criteria invoked by the Bank of Canada. More significantly, however, it also testifies implicitely to the inadequacy of monetary policy under the kind of conditions that have prevailed in Canada during the greater part of the postwar era. We will consider this matter further in Chapter VI.

The Commission also shed some light on another pertinent question: namely the allegedly unique tendency of the sales finance industry to expand loans in the face of restrictive monetary policy, especially in comparison with the banks.

> "It should also be recalled that bank lending was rising through much of this period in response to rising loan demand from both business and consumers, even though the total assets of the banks did not grow significantly. The banks were able to finance this increased lending by running

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[5] *Ibid.* (Emphasis added.)

> down their holdings of more liquid assets in which, unlike the finance companies, they find it profitable to invest on a large scale when loan demand is weak. A comparison of the growth of the sales finance companies' receivables with that in bank general loans in the periods of most rapid cyclical increase, when total bank assets were under restraint, shows that from mid-1955 to mid-1956 the increase in bank loans was $875 million, or about 27%, compared to an increase for the companies of $279 million, or 31%. In the year ending in September, 1959, bank loans actually rose more rapidly, 23% against 9% for finance company receivables; the absolute increases were $950 million and $110 million respectively.
>
> "<u>Thus, although the total assets of the companies and the banks behave differently during much of a period of restraint, their lending response has been much the same. In the latter stages of such periods however, after the banks' lending has virtually ceased to grow, the finance companies have continued to increase their receivables, particularly from business, because of their continual ability to attract funds.</u> For example, the banks' loans rose by 5% from mid-1956 to mid-1957 while the instalment finance companies increased their receivables 16%. In the six months following September 1959 when the banks' general loans declined about 3%, after allowances for seasonal variations, finance company receivables rose a further $85 million or 6%."[6]

We will explore these considerations further in the last section of this chapter. Before doing so, two other aspects of the Commission's appraisal of the sales finance industry's behaviour should be noted briefly. It pointed out, firstly, that like all operators in imperfect markets, sales finance companies cannot adopt an entirely impersonal

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[6] <u>Ibid</u>. (Emphasis added.)

approach to their customers, and respond only to short-term factors. Secondly, as to the basic determinants of fluctuations in the lending activities of the industry, the Commission significantly observes that

> "Even more than the banks, whose reactions are also delayed and incomplete, the companies are affected by demand factors. Cyclical increases in their assets thus come to an end not primarily because of the state of financial markets and shortages of funds, although they have some influence, but because the demand for automobiles and the other goods they finance ultimately weakens...."[7]

The Industry's Impact as Seen by the Bank of Canada during 1955-1956

We have alluded to the views held by the Bank of Canada concerning the sales finance industry's impact on the Canadian economy. It is now appropriate to cite them in a more complete fashion. The following passages appeared in Mr. Coyne's Annual Report for 1956:

> "A special case of credit expansion feeding on the process of activation of inactive deposits assumed significant proportions during 1955 and 1956, namely, a very large increase in the volume of consumer credit, particularly as financed by instalment finance companies. An increase in the amount of consumer credit outstanding means an increase in the amount of consumption in excess of income: such dissaving on the part of some is made possible because others consume less than their incomes. At a time when all the saving that can be accomplished is needed to provide resources for the capital investment programme and thereby expand productive capacity, diversion of an increasing amount of savings to finance consumption is something of an anomaly. The total increase of

[7] Ibid. (Emphasis added.)

consumer credit in 1956 was not as great as in 1955 because in 1956 the chartered banks reduced by $6 million their direct personal loans of this character, whereas in 1955 such loans increased by $89 million. Other forms of consumer credit increased by $250 million, in 1956, the rate of increase being particularly marked in the case of instalment finance companies and personal loan companies.

"Finance companies carry on an operation which is in all essentials banking, but are not restrained by changes in monetary conditions. They are able to compete for deposits through the sale of short-term paper in the money market and to raise funds in securities markets, paying any necessary rate of interest for these purposes, for increased interest costs do not appear to deter consumer borrowing. Banks may not charge more than 6% interest on loans. Finance companies are not limited in this respect and their rates of interest or carrying charges range from 1% to 2% per month, i.e., 12% to 24% per year, or more. Some of the companies are subsidiaries of large foreign corporations and can obtain funds directly from them. Finance companies are not required to maintain reserves nor are they subject to regulation in the way that banks, life insurance companies and some other investment institutions are.

"In a time of inflationary pressure finance companies tend to make credit 'easier'--by requiring lower down-payments and permitting longer time for repayment, as happened in 1955 and 1956 particularly in the case of automobile financing--whereas other institutions at such times try to move in the opposite direction. By encouraging a rapid increase in dis-saving (consumption in excess of income) on the part of a significant proportion of the population, a large increase in consumer credit adds to the less healthy features of a boom, and the need to pay back such increased loans may well coincide with a period of post-boom recession and increase its severity. While consumer credit may be a useful adjunct of modern merchandising, large fluctuations in the volume of such credit make it a de-stabilizing factor working against the stabilizing efforts of fiscal and monetary policy. The existence of what amounts to a rival banking system, competing for deposits and short-term funds in order to make short-term loans to finance consumption (and to an increasing extent the instalment finance companies also make loans to industrial, contracting transportation, merchandising and other businesses) without supervision or regulation, and out of step with the trend of credit policy in the regular banking system, can be a definite handicap to monetary policy during a boom, and will also have de-stabilizing effects during any recession of activity that may ensue."[8]

Accordingly, Mr. Coyne explains, he attempted to persuade the members of the sales finance industry to exercise self-restraint, but in vain. He therefore suggested to the banks that they curtail their loans to sales finance companies, and the banks did so.[9]

We have in the foregoing, with its unmistakable echoes of Gurley-Shaw rhetoric, a very comprehensive indictment of the Canadian sales finance industry. It is charged explicitely with having a general tendency to promote both inflationary and deflationary pressures. It is charged with facilitating misallocations of Canada's economic resources during inflationary times. And it is charged with having a singular capacity for obstructing monetary policy, especially of the anti-inflationary variety. It is allegedly able to subvert anti-inflationary monetary policy because the interest-inelasticity of the demand for its facilities is such that it can outbid other institutional borrowers; because it has access to the funds of foreign corporate

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[8]<u>Report of the Governor of the Bank of Canada for 1956</u>, Ottawa, Queen's Printer, 1957, pp. 25-27. (Emphasis added.)

[9]<u>Ibid</u>., pp. 8-9 and pp. 34-35.

affiliates; and because, unlike other financial intermediaries, it is not subject to any kind of public control.[10]

The Enigma of the Bank of Canada's Assessment of the Commodity Instalment Credit Situation during the Late-'Fifties

Given the time when it was released, the above indictment can, of course, be linked directly only with the events of the mid-fifties. Thus we again encounter the very intriguing and pertinent matter, mentioned in Chapter II, of the events of the late 'fifties. Then, as before, the sales finance industry behaved, as will be described in detail below, in a markedly expansionary fashion. Then, even more than before, the Bank of Canada was acutely concerned with the dangers of inflation. And then, as they had done before, the banks drastically reduced their loans to the sales finance industry. But here the resemblance between the events of the two periods ends. Notwithstanding the generality of the phraseology that had been used earlier, the Bank of Canada made no public statement on the latter occasion concerning the industry. Nor, evidently, did it make any attempt to privately urge self-restraint on its members.[11] Moreover, the Governor noted publicly[12]

[10] Mr. Coyne's 1956 indictment also implies that the effects of the sales finance industry's lendings to entrepreneurs have tended to be similar to those of its lendings to consumers. In addition, he makes no reference to the behaviour of suppliers of analogous types of credit. We will explore these considerations elsewhere in this chapter.

[11] See footnote 18 in Chapter VI.

[12] Annual Reports of the Governor of the Bank of Canada for 1958, 1959 and 1960, passim.

how the banks had expanded their own lending on consumer durables, at the very time when they were making strenuous efforts to inhibit the ability of the sales finance industry to do so. It is also relevant to recall the retrospective comment by Mr. Rasminsky to the effect that the entry of the banks into the sales finance field on a large scale during the late 'fifties was to be regarded as a rectification of an earlier inequitable situation.

This ambiguity notwithstanding, the Bank's critique of the industry's role raises, in a more explicit form than emerged in Chapter II, a number of questions as to its conception of the relevant economic forces and of its own role in relation to them. These will be discussed more exhaustively in the last chapter of this study, but it is useful to briefly foreshadow a few basic considerations here. The Bank focused its attention, and therefore its efforts, on the agent of the troublesome phenomenon rather than on the phenomenon--the excessively high levels of demand for automobiles and consumer durables--itself. In view of the fact that the Bank is a monetary institution par excellence, this preoccupation with the behaviour of other monetary institutions is perhaps understandable, but the effect, as we will see below, was to inhibit its capabilities for efficacious action. It is this failure to sufficiently distinguish between the agent and the generator of events and to recognize the character of the operative market forces that probably accounts for the Bank's tendency to almost attribute a consciously obstructive intent to the members of the sales finance industry. The fact is that sales finance companies, like firms in other uncollusive markets, must operate within the context of their individual realities. When demand for their facilities is high they must accomodate it, lest their competitors do so. They are thus obliged to solicit the necessary wherewithal from whatever sources are available, whether or not that conforms with the larger purposes of the central bank. As we will see in the next chapter, the Bank's inadequate appreciation of and response to these considerations combined with the industry's access to nonbank lenders to seriously undermine its restraining efforts.

Our main concern at this point, however, is to continue our examination of the empirical basis of the Bank's indictment of the sales finance industry, which was, after all, couched in general terms. We therefore turn to the behaviour of the industry in relation to the thrust of concurrent monetary policy and the behaviour of some other lenders during the years under review.

The Behaviour of the Industry and Certain Other Institutions Contrasted with the Thrust of Monetary Policy; 1953-1962

We now turn to the relationships that existed from 1953 to 1962 between the lending and collecting activities of the Canadian sales finance industry and the actual directional influences exerted by the Bank of Canada and, parenthetically, that of certain other suppliers of credit. It is, of course, a singularly difficult task to identify the direction in which the management of the Bank of Canada caused or wished to cause the economy to move on any given occasion. The nature of his function is such as to make it highly impolitic for a central banker to publicly declare his intentions in advance, as can, say, a minister of finance, in his annual budget speech. It is therefore necessary to infer them retrospectively from whatever ex poste utterances he chooses to make and, by analogy to Samuelson's notion of revealed preference, from the more objective behaviour of those economic variables that are most fully under his control.

The latter approach was adopted by Harry G. Johnson and John W.L. Winder, in a study of various lags in the execution of Canadian monetary policy that covers much the same interval as this study, upon which we will rely extensively below.[13] They focused their attention on the two variables in particular whose values depend primarily on Bank of Canada action: the net cash reserves of the chartered banks and the "money supply". The former is defined as the total notes and Bank of Canada deposits held by the chartered banks less Bank of Canada advances to the chartered banks under purchase and resale agreements relating to transactions involving treasury bills. The latter is defined as currency and chartered bank deposits held by the public. (There are, of course, a number of other economic variables, such as interest rates or total bank loans, over whose movements the Bank of

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[13] Op. cit., pp. 8-18.

Canada has a definite influence. But so do a variety of other parties, to a perhaps greater degree collectively, and this makes them less suitable indicators of the Bank's behaviour.)

It seems a reasonable assumption that it is the nominal rather than the real values of these two variables over which the Bank of Canada exercises the most direct control.[14] This, however, encounters the difficulty that, given the pronounced growth of the Canadian economy during the years in question and the accompanying upward movements in the level of prices, the specific turning points in these variables that would denote changes in central bank policy tend to be rather obscured. Johnson and Winder met this problem by resorting to a technique proposed by Milton Friedman, whereby intervals during which the rate of change in these variables was roughly constant are regarded as characterized by unchanged monetary policy. This makes it possible to regard the termini of such intervals as the dates at which the nature of monetary policy underwent changes.

Essential though it is to know these dates, that knowledge by itself is insufficient to identify the nature of monetary policy during either the preceding, current or following periods. Given the fact that Canada has an expanding economy, it is also necessary to know how both the new and the old rates of growth in the monetary variables compared with the rate that would have been required merely to keep pace with

[14]The movements of the real values of these variables are referred to below.

the economy's growing needs. This rate of growth in the monetary variables may be thought of as the rate needed to provide the bank deposits required to circulate the growing national income at stable prices. Thus, any change in the rates of growth of the banks' reserves and deposits that involved higher growth rates than this "neutral" one must be regarded as "expansionary". And, similarly, any change involving lower growth rates must be deemed "contractionary", even if the direction of the change is positive. Johnson and Winder derived what they called the "long run normal rate of the economy's growth" from the lowest of the forecasts of Canada's GNP in 1980 made by Wm. C. Hood and A.D. Scott for the Royal Commission on Canada's Economic Prospects: 3.8% per annum.[15] Then, because they found that the available empirical evidence suggests that the income elasticity of demand for money is approximately unity and its income velocity of circulation is generally constant, and choosing to disregard as insignificant the fact that the ratio of currency to bank deposits has been declining slowly for many years, they defined as "neutral" a monetary policy that expanded the net cash reserves of the banks at an annual rate of 3.8%. From this base they proceeded to specify the following other categories of monetary policy according to the concurrent rate of change of net cash reserves.

"extremely expansionary":	annual rate of increase of 11.4% and over
"expansionary":	annual rate of increase of 7.6% to 11.4%

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[15] Output, Labour and Capital in the Canadian Economy, Ottawa, Queen's Printer, 1958, p. 226.

"mildly expansionary":	annual rate of increase from 3.8% to 7.6%
"mildly contractionary":	annual rate of increase from 0.0% to 3.8%
"contractionary":	annual rate of decrease from 0.0% to -3.8%
"extremely contractionary":	annual rate of decrease greater than -3.8%

They then analysed the movements, over the years under review, of the banking system's net cash reserves in terms of the above criteria, and constructed Table IV-5. A corresponding analysis of changes in the size of the money supply yielded Table IV-6, and it is noteworthy that the classificatory results of the two approaches coincide closely. It is also noteworthy, as Table IV-7 shows, that where the relevant Annual Reports of the Governor of the Bank of Canada make references of a qualitative kind to monetary policy, these references, with only a few exceptions that are largely attributable to vagaries in the data,[16] add an additional dimension of endorsement to the basic meaningfulness of this classificatory technique.

Now a word on the inevitable arbitrariness of the intervals to be delineated below. Our main purpose in this exercise is to develop a general perspective as to the overall relationship between the respective

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[16] These probably arise mainly from the changed method of computing bank reserves that resulted from the 1954 revision of the Bank Act. It should also be noted that the Bank of Canada encouraged the banks to borrow from it during 1953 and 1954, in an effort to develop a Canadian money market. Johnson and Winder used the "net" cash reserves as their indicator precisely because advances from the central bank generally result from the initiative of the banks, and hence the cash involved is not really part of "required" reserves. It is therefore quite possible that the figures used are understated with respect to 1953 and 1954.

TABLE IV-5

ANNUAL RATE OF CHANGE, NET CASH RESERVES PROVIDED TO CHARTERED BANKS
SUCCESSIVE HOMOGENEOUS PERIODS FROM 1952 to 1962

Period	Annual Rate of Change (%)	Classification of Policy
1951 December - 1952 June	- 3.04	Contractionary
1952 June - 1952 September	+10.45	Expansionary
1952 September - 1952 December	- 6.38	Extremely Contractionary
1952 December - 1953 March	+15.04	Extremely Expansionary
1953 March - 1953 August	- 3.81	Extremely Contractionary
1953 August - 1953 December	+ 3.18	Mildly Contractionary
1953 December - 1954 March	- 6.30	Extremely Contractionary
1954 March - 1954 September	+ 5.46	Mildly Expansionary
1954 September - 1955 April	+ 6.62	Mildly Expansionary
1955 April - 1955 June	- 4.09	Extremely Contractionary
1955 June - 1956 January	+ 7.22	Mildly Expansionary
1956 January - 1956 September	+ 3.91	Mildly Expansionary
1956 September - 1957 April	- 3.41	Contractionary
1957 April - 1957 December	+ 1.43	Mildly Contractionary
1957 December - 1958 June	+10.78	Expansionary
1958 June - 1958 December	+21.09	Extremely Expansionary
1958 December - 1959 February	- 3.76	Contractionary
1959 February - 1959 June	+ 2.99	Mildly Contractionary
1959 June - 1960 July	- 2.98	Contractionary
1960 July - 1961 July	+ 6.48	Mildly Expansionary
1961 July - 1961 September	+ 4.48	Mildly Expansionary
1961 September - 1962 May	+11.37	Expansionary

Notes: 1. Each series seasonally adjusted and smoothed.

2. The figure for 1954 March - 1954 September is calculated on the assumption that $101 of reserves in March were equivalent to $89 in September; this assumption derives from the average cash ratios held by the chartered banks in the 1st and 2nd halves of 1954.

Source: H.G. Johnson and J.W.L. Winder, op. cit.

TABLE IV-6

ANNUAL RATE OF CHANGE, CURRENCY AND BANK DEPOSITS HELD BY GENERAL PUBLIC, SUCCESSIVE HOMOGENEOUS PERIODS FROM 1952 to 1962

Period	Annual Rate of Change (%)	Classification of Policy
1951 October - 1953 June	+ 6.69	Mildly Expansionary
1953 June - 1953 December	- 3.09	Contractionary
1953 December - 1954 June	+ 6.41	Mildly Expansionary
1954 June - 1955 August	+12.52	Extremely Expansionary
1955 August - 1957 August	+ .952	Mildly Contractionary
1957 August - 1958 October	+12.12	Extremely Expansionary
1958 October - 1959 July	+ 1.65	Mildly Contractionary
1959 July - 1959 December	- 4.21	Extremely Contractionary
1959 December - 1960 August	+ 2.91	Mildly Contractionary
1960 August - 1961 August	+ 8.94	Expansionary
1961 August - 1962 May	+ 5.96	Mildly Expansionary

Source: H.G. Johnson and J.W.L. Winder, op. cit.

TABLE IV-7

Period	Bank Report Description of Policy	Annual Rate of Change of Money Supply (%)	Classification of Policy	Annual Rate of Change of Net Reserves (%)	Classification of Policy
1951 July - 1952 January	Expansion	+ 4.55	Mildly Expansionary	+12.68	Extremely Expansionary
*1952 January - 1952 July	Restriction	+ 5.78	Mildly Expansionary	- 2.11	Contractionary
1952 July - 1953 January	Expansion	+ 7.82	Expansionary	+ 4.59	Mildly Expansionary
1953 January - 1953 October	Restriction	+ 2.36	Mildly Contractionary	+ 0.94	Mildly Contractionary
*1950 July - 1953 July	Restriction	+ 4.48	Mildly Expansionary	+ 4.29	Mildly Expansionary
*1953 October - 1953 December	Expansion	- 7.87	Extremely Contractionary	+ 3.52	Mildly Contractionary
1953 October - 1955 September	Expansion	+ 8.51	Expansionary	+ 5.10	Mildly Expansionary
1955 September - 1957 August	Restriction	+ 0.91	Mildly Contractionary	+ 1.35	Mildly Contractionary
1957 August - 1958 October	Expansion	+12.12	Extremely Expansionary	+12.00	Extremely Expansionary
1958 October - 1960 October	Restriction	+ 1.35	Mildly Contractionary	- 0.38	Contractionary
1960 October - 1962 May	Expansion	+ 7.29	Mildly Expansionary	+ 9.43	Expansionary

Notes: 1. Stars denote conflicts of classification.
2. The calculation of the rate of change of net cash reserves for 1953 October - 1955 September assumes that $101 of reserves in 1953 was equivalent to $89 worth of reserves in 1955.

Source: H.G. Johnson and J.W.L. Winder, <u>op. cit.</u>

influences on the aggregate level of spending that the Bank of Canada and the sales finance industry brought to bear between 1953 and 1962. It is clearly desirable that, owing to the vagaries of the data pertaining to the Bank's behaviour, on the one hand, and the frequency with which the indicators suggest qualitative policy change, on the other, the intervals not be so brief as to be unduly vulnerable to the vagaries but still short enough to reflect the rapidly changing monetary policies that characterized those years. We will therefore collect the various sub-intervals into homogeneous sets of roughly one year's duration, largely disregarding the Johnson and Winder quantitative distinctions, and use these sets as the context within which to examine the concurrent movements of the indicators of the industry's activities. Since it seems reasonable to assume that the Bank of Canada has somewhat more immediate and direct influence over the net cash reserves of the chartered banks than it does over the money supply, we will use the classificatory system based on their variations as our basic reference. As Tables IV-5 and IV-6 show, however, we would get broadly similar results from the movements of the money supply series. Also, as Tables IV-8 and IV-9 show, the real versions of the net cash reserves and the money supply series suggest somewhat different dates of policy changes than the nominal versions do. (Although the purposes of this exercise would be adequately served by confining the analysis to the dates suggested by the nominal versions, it is appropriate, when the general circumstances so warrant, to keep in mind those implied by the real ones.)

TABLE IV-8

ANNUAL RATE OF CHANGE, NET RESERVES PROVIDED TO CHARTERED BANKS, DEFLATED BY CONSUMER PRICE INDEX, 1952-1962

Period	Annual Rate of Change	Comparison with Nominal Net Reserves Indicator	
		Lead (+) or Lag (-) of Change	Rate of Change of Nominal Net Reserves in Comparable Period
	(%)	(months)	(%)
1951 October - 1952 September	+10.34	-2	
1952 September - 1952 December	-11.22		
1952 December - 1953 May	+14.29		
1953 May - 1953 September	- 8.66	+2	-3.81
1953 September - 1953 December	+ 5.46	-1	+3.18
1953 December - 1954 April	- 8.62	-1	-6.30
1954 April - 1954 September	+16.67	-1	+5.46
1954 September - 1955 May	+ 3.49		+6.62
1955 May - 1955 August	+12.37	+1	-4.09
1955 August - 1955 November	- 2.09	-4	+7.22
1955 November - 1956 May	+ 6.16	-5	
1956 May - 1957 August	- 4.41	+4	
1957 August - 1958 April	+ 5.90	+4	
1958 April - 1958 November	+16.76	+2	
1958 November - 1960 October	- 5.66	+1	-2.18
1960 October - 1961 August	+ 7.52	-3	
1961 August - 1962 April	+11.94	+2	

Notes:
1. Both series seasonally adjusted.
2. The rate of change for 1954 April - 1954 September is calculated on the assumption that $100 of reserves in April were equivalent to $89 of reserves in September.
3. The final two columns are derived from Table IV-5; for clarity, figures are entered only in cases of significant divergence.

Source: H.G. Johnson and J.W.L. Winder, <u>op. cit.</u>

TABLE IV-9

ANNUAL RATES OF CHANGE, CURRENCY AND BANK DEPOSITS HELD BY GENERAL PUBLIC, DEFLATED BY CONSUMER PRICE INDEX, 1952-1962

Period	Annual Rate of Change	Comparison with Nominal Money Supply Indicator	
		Lead (+) or Lag (-) of Change	Rate of Change of Nominal Money in Comparable Period
	(%)	(months)	(%)
1951 October - 1953 April	+ 7.98		
1953 April - 1953 December	- 2.11	+2	
1953 December - 1954 June	+ 4.95		
1954 June - 1955 August	+12.77		
1955 August - 1957 September	- 1.65		+ .952
1957 September - 1958 May	+ 6.49	) -1	
1958 May - 1958 October	+17.95	)	
1958 October - 1959 April	+ 1.39		
1959 April - 1959 December	- 4.55	+3	
1959 December - 1960 August	+ 1.55		
1960 August - 1961 August	+ 8.04		
1961 August - 1962 May	+ 4.54		

Notes: 1. Both series seasonally adjusted.

2. The final two columns are derived from Table IV-5; for clarity, figures are entered only in cases of significant divergence.

Source: H.G. Johnson and J.W.L. Winder, op. cit.

As was shown earlier, the various offsetting effects associated with the activities of sales finance companies will vary considerably during different phases of the business cycle. Hence, unless we know something about the nature of the concurrent phase during which a given change occurred in the industry's scale of operations, we cannot hazard a meaningful estimate as to the direction and still less as to the relative magnitude of its impact on aggregate spending. The peaks and troughs of the reference cycles used above with respect to the Canadian economy for most of the years under review will therefore be superimposed on our temporal format.

A further comment on the subject of the measurements of the activities of the sales finance industry as suppliers of commodity instalment credit is appropriate here. A total of four criteria will be utilized: total balances outstanding, paper purchased (new loans extended), repayments, and change in total balances outstanding. When we discussed the phenomenon of commodity instalment lending in hypothetical terms above, it was suggested that it could reasonably be assumed that repayments by debtors implied corresponding reductions in their current demand. That assumption enabled us to utilize the movements of total balances outstanding as an unambiguous indicator of the direction of the impact on aggregate current demand produced by this type of credit. Although it is impossible to prove in either a priori or a posteriori terms that no part of current repayments came from previously-accumulated savings, and therefore that the movement of total balances outstanding is definitely not unambiguous in its effects on the level of aggregate current spending,[17] this assumption will be maintained, for the reasons given earlier. The fact is, however, that the direction in which this indicator is moving, since it is determined by the direction in which the spread between them is moving, does not in itself specify uniquely the directions in which its two components, new loans extended and repayments, are moving. It will often be useful to know their movements, and we will therefore show them separately. The change-in-balances-outstanding indicator is intended to serve as one of the references to changes in the intensity of the impact of sales financing on aggregate current spending.

April, 1953 to March, 1954

This interval, according to the Johnson-Winder net cash reserves classificatory system, depicted on Table IV-5, was one of monetary policies of varying degrees of contraction. The immediately preceding sub-interval, however, December, 1952 to March, 1953, was "extremely expansionary" indeed. This is all the more relevant when it is noted that the sub-interval before, September to December, was "extremely contractionary". The setting for the specific interval under consideration

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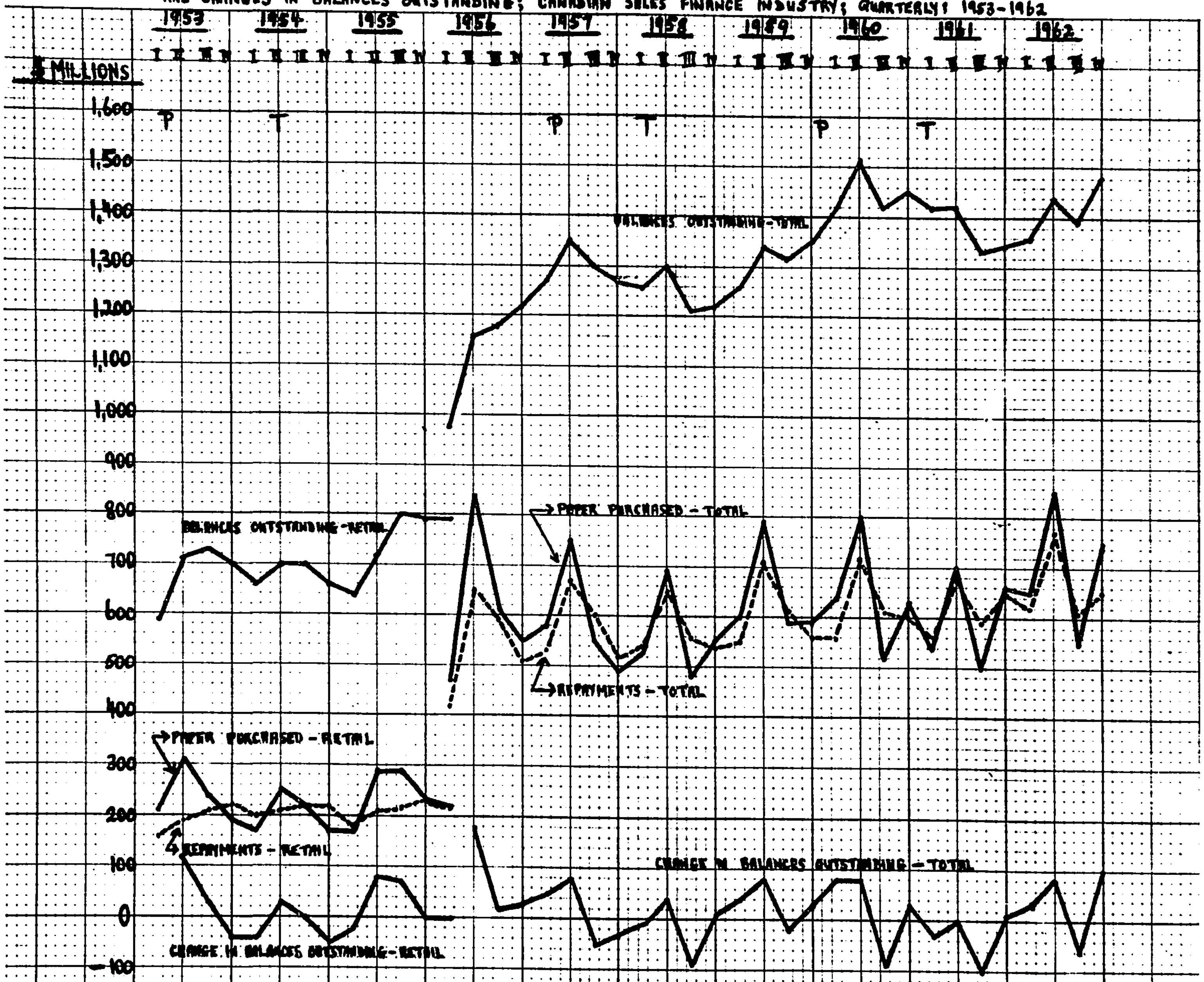
[17]A variety of paradoxical effects could otherwise be attributed to a given movement of total outstandings. On balance, it is highly likely that the degree of uncertainty that would thus arise exceeds the probably minor one produced by the assumptions made above. These assumptions are also generally made in the literature.

that thus emerges is scarcely one of overall tranquility. That was particularly true of the field of instalment credit. It underwent unprecedented expansion during the previous half-year because of the lifting, in May, 1952, of the severe restrictions imposed on it uniquely by special decree at the outset of the Korean War. A plateau, however, had been reached by the end of the first quarter of 1953.

Data are not available for this period for the "total" versions of the four indicators defined above with respect to the lending activities of the sales finance industry. They have therefore been expressed in terms of retail operations; a form that is quite acceptable for present purposes, since lending on transactions at the retail level constitutes overwhelmingly the major component of the industry's total lending. Looking at the interval as a whole, it will be seen, from Chart IV-4, that the paper-purchased indicator moved in an upward direction only during the first quarter. During the remaining three quarters it moved in a more or less steadily downward, contracyclical, direction. The increase during the first quarter amounted to $99 million. It was followed in the next quarter by a decrease of $69 million. The decreases during the last two quarters were $45 million and $29 million respectively. In consequence, the volume of new loans extended at the end of the period turned out to be some $40 million below what it had been at the start.

As for the volume of repayments, it rose steadily but at a decreasing rate for the first three quarters. This was due to the

CHART IV-4 BALANCES OUTSTANDING, PAPER PURCHASED, REPAYMENTS, AND CHANGES IN BALANCES OUTSTANDING; CANADIAN SALES FINANCE INDUSTRY; QUARTERLY: 1953-1962 - SOURCE: BANK OF CANADA



substantial increase in loans extended during the first quarter, on the one hand, and the decrease in loans extended during the second quarter on the other. However, they remained throughout most of these nine months below the level of new loans, causing thereby weakening but still positive changes in balances outstanding. Throughout the rest of the third and all of the fourth quarter, repayments exceeded new loans extended and, as a result, balances outstanding fell by about $70 million from the total recorded at the end of the second quarter.

It was only during the first of the four quarters under review that the industry's operations qualified as even potentially expansionary, and therefore opposed to the direction of monetary policy. Balances outstanding rose by $122 million, but when we note that it took place at a time when the level of business activity was at its peak, and therefore was probably accompanied by a large offsetting diversion of credit from other borrowers, it is by no means clear that it produced a significant positive net impact on spending. The same can be said, _a fortiori_, of the much smaller increase in balances outstanding of $30 million that occurred during the next quarter, under fairly high-activity business conditions. The industry's impact during the last two quarters was obviously contractionary. Its impact over the interval as a whole, however, was expansionary.

Since the reference cycle peaked in May, 1953, as Chart IV-4 indicates, this means that after the first month the level of business activity declined steadily. That implies that the impact of the industry was contracyclical over almost the entire interval, but the same is not true of the thrust of monetary policy. It is therefore apparent that monetary policy's cyclical direction during almost the whole of this particular interval was opposed by the industry's activities.

The behaviour of certain other suppliers of consumer credit during these four quarters is rather interesting. As Table IV-10 shows, charge accounts outstanding rose altogether by $30 million, almost entirely during the last two quarters. A slightly larger increase of $35 million occurred in instalment receivables held by retailers, mainly during the third quarter. The banks and the small loan companies increased their receivables from personal debtors by around $100 million; the increase being distributed over the entire interval, with the largest portion occurring in the second quarter.

The total lending activities of the banks are much less directly linked to the current level of spending than those reviewed above. For one thing, a substantial proportion of their loans are made to various financial institutions who then re-lend or otherwise disburse the funds involved to others, who do not necessarily spend them on goods and services. The same holds true for the also substantial lending that banks do to governments at the provincial and municipal levels and to various public institutions. As for loans to personal, agricultural, industrial and commercial borrowers, here the link with the current level of spending is undoubtedly much more direct, although a certain minor proportion probably represents refinancing of previously-incurred

TABLE IV-10

CONSUMER CREDIT OUTSTANDING, ESTIMATES OF SELECTED ITEMS, 1952 to 1956
(millions of dollars)

Period	Charge Accounts	Instalment Credit: Retail Dealers	Instalment Credit: Finance and Loan Companies	Instalment Credit: Total	Cash Personal Loans	Total of Selected Items
	1	2	3		4	
1948 - Mar. 31	166	81	52	133	238	537
June 30	170	92	67	159	251	580
Sept. 30	168	99	70	169	255	592
Dec. 31	208	127	71	198	263	669
1949 - Mar. 31	181	115	72	187	264	632
June 30	190	127	99	226	282	698
Sept. 30	187	135	109	244	292	723
Dec. 31	228	161	116	277	302	807
1950 - Mar. 31	196	145	122	267	310	773
June 30	195	158	162	320	340	855
Sept. 30	200	174	192	366	367	933
Dec. 31	255	199	202	401	378	1,034
1951 - Mar. 31	239	163	216	379	387	1,005
June 30	219	141	224	365	393	977
Sept. 30	219	122	215	337	380	936
Dec. 31	283	123	186	309	381	973
1952 - Mar. 31	244	116	176	292	380	916
June 30	231	163	265	428	417	1,076
Sept. 30	241	192	334	526	435	1,202
Dec. 31	309	243	373	616	460	1,385
1953 - Mar. 31	283	242	426	668	477	1,428
June 30	268	247	524	771	525	1,564
Sept. 30	269	254	551	805	545	1,619
Dec. 31	339	284	520	804	567	1,710
1954 - Mar. 31	313	278	500	778	567	1,667
June 30	300	284	526	810	615	1,725
Sept. 30	297	285	532	817	635	1,749
Dec. 31	363	322	497	819	661	1,843
1955 - Mar. 31	301	304	497	801	675	1,777
June 30	317	314	561	875	743	1,935
Sept. 30	330	334	613	947	779	2,056
Dec. 31	374	377	605	982	830	2,186
1956 - Mar. 31	332	360	604	964	852	2,148
June 30	339	367	713	1,080	896	2,315
Sept. 30	349	377	785	1,162	901	2,412
Dec. 31	389	408	769	1,178	910	2,477

Notes:
1. Consumers' charge accounts receivables outstanding on the books of retail dealers.
2. Consumers' instalment receivables outstanding on the books of retail dealers.
3. Instalment paper held in connection with the financing of retail purchases of consumer goods, largely new and used automobiles. In addition to the paper held by sales finance and acceptance companies as reported in the D.B.S. publication "Sales Financing", these totals include estimates of the instalment paper held by small loan companies and licensed money lenders.
4. Includes estimated personal loans by chartered banks, small loan companies, licensed money lenders and credit unions.

Source: Bank of Canada. (The tabulation in this form was discontinued after 1956.)

debts and the like. During the first of the four quarters under review bank loans receivable from agricultural, industrial and commercial borrowers rose by $145 million. They rose by $185 million in the second quarter, and remained at the same level from then to the end of the interval.[18]

April, 1954 to April, 1955

These four quarters can, for all practical purposes, be regarded as having been characterized by continuous "mildly expansionary" monetary policies. (The abovementioned decennial revision of the Bank Act stipulated, as we know, a change in the method of computing the cash reserves held by the chartered banks, and it is probably this, rather than anything more substantial, that accounts for the jump of approximately 1% recorded during September.) As before, it is useful to place the interval into perspective by recalling that the immediately preceding quarter had been subjected to "extremely contractionary" monetary policy. It, in turn, had been preceded by three quarters that had seen monetary policies of varying degrees of contraction.

During the first quarter retail paper purchased by the sales finance industry increased by $80 million. This increase might be thought surprising, considering the downward direction in which the economy was

[18] This reference to the lending behaviour of the banks is based, as are all such references in this section, on detailed data published in the Statistical Summary of the Bank of Canada for the years in question.

moving and in view of the similar behaviour of this indicator during the corresponding quarter of the year before, when the economy was approaching the peak of an upswing. Any such impression, however, is immediately dispelled when it is realized that there are other basic tendencies at work in these processes which, although we have not yet done so explicitly, must be taken into consideration. Most of the markets for consumer durables are subject to seasonal influences of one kind or another, but none more pronouncedly than the markets for new and used automobiles. It would surely be hard to find a commodity in our culture whose image, and consequently its market value, is so dependent on vintage as is the automobile. Hence, the fact that the models for a given year appear on the market in the fall of the preceding calendar year is a distinctly significant one. However, another highly relevant factor is the impact of the winter on Canadian automobile markets. Its onset, in a word, signifies the arrival of conditions that blight the functional, and even more so, the aesthetic, potentialities which we attribute to the automobile. This and the aforementioned consideration coincide in terms of the calendar. Their effects therefore tend to offset one another. As a result, only the advent of spring releases these pent-up demand forces; and the ensuing quarter can, as a general rule, be expected to reflect them. If we set aside the possibility that cash buyers of automobiles respond differently from those who buy on credit, we can clearly observe these influences at work, during the summer months of all the intervals under discussion here.

The expansionary potentialities of the increase in new loans extended that occurred during this first quarter were partly offset by the relatively high level of repayments inherited from the year before, but there is no doubt that the net impact of the industry's lending operations was expansionary. The same can also be said to a lesser degree of their net impact during the second quarter. The level of new loans extended fell by about $30 million, but it remained above the level of repayments until the very end of the quarter, when the two indicators drew even. The industry's lending activities produced clearly contractionary effects during the third quarter. New loans extended decreased by some $50 million, while collections remained at the level reached at the end of the previous quarter. During the final quarter new loans levelled-off while repayments declined, although they were consistently higher than new extensions--by the end of the quarter they exceeded them by about $20 million. The change-in-balances-outstanding indicator conveys the prevailing state of affairs quite clearly. It had stood at the end of the third quarter at -$50 million, but now it was at the -$20 million mark. Obviously the contractionary forces that animated it during the quarter had weakened.

The experience of this interval constitutes another clear example of conflict between the behaviour of the industry and the thrust of monetary policy, particularly when it is noted that the economy was then operating at a relatively low level of activity and, therefore, it is likely that the industry's net withdrawal of funds probably went into excess lending capacity. It is interesting to observe, however, that the conflict occurred largely because the industry's outstandings varied in a largely contracyclical fashion, while monetary policy was predominately procyclical.

The fact that monetary policy during this interval qualified as "mildly expansionary" notwithstanding, the banks as a group failed to expand their overall lending operations, except for a few intermittant and temporary occasions. In fact, they actually reduced their total loans outstanding by $70 million. With only the single minor, but interesting, exception of cash personal loans, which increased by some $100 million, the general field of consumer credit exhibited, as Table IV-10 shows, much the same reluctance to expand.

All in all, the various other purveyors of credit responded quite sluggishly to the opportunities for expansion that arose from the increased lending capabilities with which the central bank endowed the chartered banks. Each expanded its lending activities slightly, or at least refrained from contracting them significantly. But, as was implied above with respect to the sales finance industry, it seems doubtful that their collective behaviour fulfilled the hopes of the Bank of Canada.

May, 1955 to September, 1956

This interval of approximately sixteen months was, with one relatively brief interruption, characterized by "mildly expansionary" monetary policies. It can therefore be regarded as being essentially the latter part of the longer interval, that began in April, 1954, during which the Bank of Canada was trying to foster an increase in the level of general economic activity. The interruption, during which the Bank was trying to lean in a definitely contractionary direction, probably lasted no more than three or four months, but is rather difficult to locate precisely because the various policy indicators suggest slightly different termini. It is probable that it occurred during the two middle quarters of 1955. Another minor difficulty arises from our utilization of the availability, beginning in April, 1956, of the "total" versions of the industry indicators that we have been using. However, given the proportional importance of the "retail" versions to the size of the "total" ones, it seems virtually certain that they usually varied in similar directions.

The impact of the industry's lending operations was clearly procyclical and expansionary during the first five months of the interval under review. Total (retail) outstandings increased by approximately $50 million. This was the result of the sharp increase during the early months in the level of new loans, which caused balances outstanding during the later months to go on rising even after new loans had levelled-off. It is around this point that the brief conflict with the abortive contractionary pressure exerted by the Bank of Canada existed: otherwise the industry and the Bank leaned in the same upward direction. Some further slight conflict between these two tendencies developed during the next two quarters, when new loans fell first by $60 million and then by $165 million, causing balances outstanding to first become and then remain level with the total recorded at the end of the preceding quarter. The fact that the economy was then operating around the mid-point of its upswing from the trough of June, 1954 confirms the impression that the industry's influence was either neutral or very mildly contractionary, in contradistinction to the upward thrust of monetary policy.

Switching now to the "total" versions of the indicators, we observe that there was a definite parallel between the directional behaviour of the industry and the Bank during the last two quarters. If anything, the expansionary influence exerted by the industry exceeded that intended by the Bank, although this influence was possibly mitigated towards the end by the fact that the economy had entered the later stages of its upswing. During the first of these quarters total outstandings rose by $180 millions, owing to a huge $370 million increase in new loans extended. So great was the upward push of this increase that it caused total outstanding to increase a further $20 million during the next quarter, even though new loans extended were falling by $230 million.

We can observe at this point the basis of the genesis, or at least the strengthening, of the impression in the minds of the management of the Bank of Canada that the sales finance industry characteristically operated in a fashion that tended to undermine monetary policy. Here was the Bank getting ready to reverse the direction of its pressure on the economy (indeed, by some criteria, it had already been doing so for about one quarter) while the industry's influence was not only in the opposite direction but seemed likely to so continue for some time to come.

The overall behaviour of the banks during this interval was also distinctly expansionary. Total loans outstanding rose by around $1 billion, of which approximately $800 million were in the category of general loans. Virtually the whole of the increase took place during the first four quarters, when monetary policy was most unambiguously expansionary, with the one minor exception noted above. During the last two quarters, when monetary policy was probably least expansionary, total loans outstanding, again especially general loans, tended to remain stable. In their lending to private individuals the banks followed a pattern that was roughly similar to the one traced by the sales finance industry. As for the activities of the various other suppliers of consumer credit that are roughly analogous to that of sales finance companies, they all tended, as Table IV-10 shows, to be expansionary over the interval as a whole.

October, 1956 to December, 1957

The experience of this interval, especially during its earlier phases, constitutes another example of conflict between the behaviour of the Bank of Canada and the influence on total spending exerted by the sales finance industry. The annual rates of changes of the net-cash-reserves indicator imply that the Bank behaved in a fashion conducive to contractionary consequences; a likelihood strengthened by the fact that the reference cycle peaked during the interval and by a wide variety of other circumstances.[19] The industry's total-balances-outstanding indicator rose by some $160 million during the first three of the five quarters under consideration. The occurrence, however, in April, 1957, of the peak of the reference cycle suggests that the offsetting reductions in other forms of outstanding credit were probably substantial, especially during the third quarter, so that it is again questionable whether the industry's activities rendered the aggregate level of spending appreciably higher than it would otherwise have been. It is also interesting to observe that during the first of these three quarters the level of new loans extended actually fell, by $60 million, (but repayments fell even more, by $75 million). It rose during the next two quarters, however, by $35 million and $170 million respectively.

There is no question that the industry's impact was contractionary during the fourth and fifth quarters, as was the thrust of monetary policy. Total balances outstanding fell, first by $45 million and then by $35 million. Given the fact that a downswing was by now well under way, most of this net withdrawal must have gone into excess lending capacity of the financial institutions who provided the industry's funds at that time. New loans extended by the industry fell sharply, by $195 million and $65 million, but the effects of these decreases were modified by the accompanying reductions, of $70 million and $75 million, in the level of repayments.

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[19] See E.P. Neufeld, op. cit., pp. 296-298, for a succinct but illuminating summary of the concurrent economic conditions, which are also described in the Annual Reports of the Governor of the Bank of Canada for 1956 and 1957.

The lending activities of the banks were generally consistent with contractionary monetary policy during all five quarters, during which the level of general loans outstanding remained fairly stable, although it did rise temporarily by $150 million during the two middle quarters of 1957. Their loans to private borrowers, however, fell steadily by some $60 million altogether.

Instalment lending by department stores and other retailers followed much the same pattern that lending to consumers by sales finance companies did. The tendency was one of steady, if uneven, increase, especially during 1957.[20]

January, 1958 to December, 1958

The annual rates of increase of the net cash reserves variable during this distinctly "expansionary" interval were unusually high: 10.78% during the first two quarters and 21.09% during the last two. The overall impact on the aggregate level of spending of the lending operations of the sales finance industry was, on the other hand, distinctly contractionary; thus producing a situation of even sharper conflict between the behaviour of the Bank of Canada and that of the industry than the one reviewed in the preceding section.

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[20] This clearly indicates, incidentally, that, during the last two quarters of 1957, it was the sales finance industry's loans to firms that were most stringently reduced. That, of course, is what we would expect during a downswing in the general level of economic activity.

At first the conflict was mild, and there were even two quarters when the two tendencies moved in parallel directions. During the first quarter of 1957 total outstanding fell by $15 million. This occurred in spite of the fact that new loans extended rose by $35 million. Repayments, which had been at a higher level than new loans at the start of the quarter also increased by $25 million, and therefore remained higher than new loans throughout the quarter. The second quarter was one of consistency between the industry and the central bank. Total outstandings rose by $40 million. This was due to the increase of $190 million in the level of new loans, which brought it above the level of repayments, although they also increased by $155 million.

The conflict was at its sharpest during the third quarter. Total outstandings fell by $90 million due to a decrease of $210 million in the level of new loans; a fall that brought it below the level of repayments, which also fell by $80 million. Given the fact that the economy had just recently reached a trough, in April, and was still in the beginning of its upswing, there is little doubt that the industry's large net withdrawal of funds went into excess lending capacity of the monetary system. Total outstandings rose by $10 million during the last quarter, because new loans increased by $80 million while repayments fell by $20 million.

Once again, as is to be expected under general economic conditions of this kind, it was entrepreneurs rather than consumers who most restricted their borrowings from the industry. As Table IV-11 shows, total consumer indebtedness to the industry stood at the end of the year at

TABLE IV-11

FINANCE COMPANY AND RETAIL DEALER CREDIT EXTENDED TO CONSUMERS, BALANCES OUTSTANDING, 1957 to 1962

Period	Small Loan Companies			Department Stores Instalment Credit				Other Retail Dealers (4)		
	Instal-ment Finance Companies (1)	Instal-ment Credit (2)	Cash Loans (3)	Condition-al Sale Agreements	Other Deferred Payment Plans	Charge Accounts	Sub-Total	Instal-ment Credit	Charge Accounts	Total Finance Companies and Retail Dealers
	(millions of dollars)									
1957 - Jan.	743	14	336	158	75		1,327	*	*	*
Feb.	736	14	334	154	69		1,307	*	*	*
Mar.	737	14	334	149	27	38	1,299	248	269	1,816
Apr.	757	14	335	151	28	41	1,326	*	*	*
May	781	14	336	151	28	41	1,352	*	*	*
June	796	14	340	150	29	42	1,371	253	274	1,898
July	816	14	340	149	28	36	1,384	*	*	*
Aug.	826	14	342	150	27	37	1,397	*	*	*
Sept.	822	14	339	153	28	41	1,397	258	290	1,945
Oct.	815	15	336	157	28	43	1,394	*	*	*
Nov.	801	15	338	163	29	45	1,391	*	*	*
Dec.	780	15	347	173	36	53	1,404	271	293	1,968
1958 - Jan.	766	16	340	170	33	44	1,369	*	*	*
Feb.	757	15	340	165	31	39	1,347	*	*	*
Mar.	755	15	351	162	31	39	1,353	251	269	1,873
Apr.	770	15	358	161	31	40	1,375	*	*	*
May	785	16	362	162	30	40	1,395	*	*	*
June	796	16	368	162	29	40	1,411	254	276	1,941
July	804	17	374	160	28	38	1,421	*	*	*

TABLE IV-11 (Continued)

Period	Instal-ment Finance Companies (1)	Small Loan Companies: Instal-ment Credit (2)	Small Loan Companies: Cash Loans (3)	Department Stores Instalment Credit: Condition-al Sale Agreements	Department Stores Instalment Credit: Other Deferred Payment Plans	Charge Accounts	Sub-Total	Other Retail Dealers (4): Instal-ment Credit	Other Retail Dealers (4): Charge Accounts	Total Finance Companies and Retail Dealers
				(millions of dollars)						
1958 - Aug.	808	17	376	161	28	38	1,428	*	*	*
Sept.	801	17	375	164	29	43	1,429	258	285	1,972
Oct.	791	18	372	168	29	46	1,424	*	*	*
Nov.	779	18	376	175	31	49	1,428	*	*	*
Dec.	768	19	382	187	37	58	1,451	266	313	2,030
1959 - Jan.	745	25	382	217		49	1,418	*	*	*
Feb.	742	25	381	210		43	1,401	*	*	*
Mar.	744	26	385	205		42	1,402	251	288	1,941
Apr.	759	28	390	204		43	1,424	*	*	*
May	770	29	396	206		44	1,445	*	*	*
June	793	31	400	205		43	1,472	253	289	2,014
July	809	32	409	204		40	1,494	*	*	*
Aug.	813	33	417	203		40	1,506	*	*	*
Sept.	817	34	422	208		46	1,527	258	301	2,086
Oct.	820	36	429	215		50	1,550	*	*	*
Nov.	816	37	434	228		53	1,568	*	*	*
Dec.	806	38	446	250		64	1,604	274	327	2,205
1960 - Jan.	794	39	446	246		57	1,582	*	*	*
Feb.	789	41	447	240		48	1,565	*	*	*
Mar.	791	40	453	238		46	1,568	256	296	2,120

TABLE IV-11 (Continued)

Period	Small Loan Companies: Instalment Finance Companies (1)	Small Loan Companies: Instalment Credit (2)	Small Loan Companies: Cash Loans (3)	Department Stores Instalment Credit: Conditional Sale Agreements	Department Stores Instalment Credit: Other Deferred Payment Plans	Charge Accounts	Sub-Total	Other Retail Dealers (4): Instalment Credit	Other Retail Dealers (4): Charge Accounts	Total Finance Companies and Retail Dealers
				(millions of dollars)						
1960 - Apr.	805	42	463	242		48	1,600	*	*	*
May	827	44	470	245		50	1,636	*	*	*
June	844	45	479	247		49	1,664	259	296	2,219
July	854	46	485		292		1,677	*	*	*
Aug.	856	47	489		294		1,686	*	*	*
Sept.	851	47	490		305		1,693	258	304	2,255
Oct.	842	47	494		313		1,696	*	*	*
Nov.	839	46	494		328		1,707	*	*	*
Dec.	828	45	504		368		1,745	267	325	2,337
1961 - Jan.	809	45	500		354		1,708	*	*	*
Feb.	793	44	501		339		1,677	*	*	*
Mar.	784	43	506		332		1,665	252	298	2,215
Apr.	785	43	512		331		1,671	*	*	*
May	790	42	519		334		1,685	*	*	*
June	797	42	526		336		1,701	252	306	2,259
July	808	38	529		328		1,703	*	*	*
Aug.	805	38	534		331		1,708	*	*	*
Sept.	794	38	534		339		1,705	259	311	2,275
Oct.	782	35	535		347		1,700	*	*	*
Nov.	766	36	546		358		1,706	*	*	*
Dec.	756	35	559		401		1,752	270	335	2,357

TABLE IV-11 (Continued)

Period	Small Loan Companies			Department Stores Instalment Credit				Other Retail Dealers (4)		
	Instal-ment Finance Companies (1)	Instal-ment Credit (2)	Cash Loans (3)	Condition-al Sale Agreements	Other Deferred Payment Plans	Charge Accounts	Sub-Total	Instal-ment Credit	Charge Accounts	Total Finance Companies and Retail Dealers
					(millions of dollars)					
1962 - Jan.	743	35	562		387		1,727	*	*	*
Feb.	737	36	566		370		1,709	*	*	*
Mar.	739	37	576		359		1,711	249	305	2,265
Apr.	755	39	586		366		1,746	*	*	*
May	771	40	595		367		1,773	*	*	*
June	782	42	604		364		1,793	251	313	2,357
July	795	43	614		356		1,808	*	*	*
Aug.	805	45	625		356		1,831	*	*	*
Sept.	798	49	631		366		1,844	253	314	2,411
Oct.	798	49	635		372		1,854	*	*	*
Nov.	799	50	644		385		1,878	*	*	*
Dec.	801	52	662		427		1,942	269	343	2,554

Notes: 1. Conditional sale agreements held in connection with the financing of retail purchases of consumers' goods.
2. Companies licensed under the Small Loans Act and affiliated companies engaged in making personal loans.
3. Cash loans with no conditional sale contract but usually repaid in instalments.
4. Data are based on DBS series. Excluded from these figures are charge accounts of motor vehicle dealers whose credit is extended mainly to businesses rather than to consumers.

* Not available.

Source: Bank of Canada.

almost exactly the same level that had existed at the start. With minor variations the same can be said of consumer indebtedness to retail dealers. Interestingly, the banks significantly increased their personal loans during the year, by $170 million. Their loans outstanding to non-farm entrepreneurs, however, fell steadily, by $140 million altogether. It was only the above increase in lending to individuals plus a $45 million increase in farm loans and loans to religious and other public institutions that enabled the banks to expand general loans outstanding by $75 million, and thereby avoid producing a definitely contractionary impact on the economy.

January, 1959 to July, 1960

This rather long interval extends from around the middle of an upswing to around the middle of the following downswing. It was an interval of generally contractionary monetary policy and constitutes yet another, and perhaps the most striking of the examples considered of conflict between the behaviour of the Bank of Canada and that of the sales finance industry.

Although the constituents of the industry's impact through its lending operations varied widely in their respective directional behaviour, they caused the total-balances-outstanding indicator to move, with only two minor exceptions, in a consistently expansionary direction. Its first sharp increases occurred during the first two quarters, when the total increase amounted to $125 million. New loans extended rose by

$235 million, placing them at a level that always remained above that of repayments, although they too rose, by $160 million. Because their level temporarily fell below that of repayments during the next quarter, when new loans decreased by $200 million while repayments decreased by only $95 million, total outstandings fell by $25 million and produced a brief period of harmony between the industry and the monetary authorities. Disharmony returned during the following quarter and continued until almost the end of the interval. Total outstandings rose during that quarter by $30 million, because repayments had continued to fall while new loans remained at a constant, but higher, level. The reference cycle reached its peak during the first quarter of 1960. This was accompanied by a rise of $80 million in new loans while repayments remained constant. It may, therefore, again be questioned whether the industry's activities during this quarter actually rendered the aggregate level of spending significantly higher than it would otherwise have been. No such question, however, arises with respect to the final quarter: here again the clash between the directions pursued by the industry and the central bank is unmistakable. Total outstandings again increased by $80 million in consequence of increases of $160 million in both new loans and repayments. The interval closed, as Chart IV-4 shows, with a short-lived consistency between the industry and monetary policy. The very sharp downswing in the level of new loans caused total outstandings to start falling about one month before the Bank of Canada switched to expansionary efforts.

Given the generally rising levels of economic activity embraced by this interval, it is not surprising that some $200 million out of the $300 million increase in total outstandings recorded by the industry represented increased indebtedness by firms. About one-half of the $100 million in consumer indebtedness, however, occurred after the reference cycles had peaked, lending some further credence to Mr. Coyne's assertions quoted earlier. Broadly similar expansionary behaviour was displayed by the various other suppliers of consumer credit, as Table IV-11 shows.

It is noteworthy that the lending operations of the banks were, like those of the industry, generally opposed to the thrust of monetary policy during most of this interval. Their general loans outstanding increased by around $850 million. Increased loans to individuals accounted for $235 million.

August, 1960 to May, 1962

During roughly the first two-thirds of this interval there was usually conflict between the impact of the lending operations of the sales finance industry on the aggregate level of spending and the expansionary efforts of the Bank of Canada. This situation changed during the latter part of the interval when the industry's impact was also expansionary. The overall relationship, however, was one of disharmony.

The interval began with the continuation of the downturn in the level of total outstandings that had begun around the end of the previous interval. The quarter in question saw it fall by $90 million, as the result of a sharp decrease, in the amount of $285 million, in the level of new loans. Repayments also fell, but by only $110 million. New loans increased by $115 million during the next quarter while repayments continued to fall, by $15 million. This caused total outstandings to once again rise, by $35 million, creating a temporary harmony between the effects of the industry and the central bank. The next three quarters were respectively ones when the industry opposed, was neutral in relation to, and again opposed, the thrust of monetary policy. During the first quarter total outstandings fell by $30 million, because new loans had fallen by $95 million and repayments by $45 million. There was no change in the level of total outstandings during the next quarter, during which new loans increased by $155 million and repayments by $125 million. Total outstandings again fell, however, during the third quarter, by $100 million, since new loans declined by $195 million and repayments by $95 million.

The balance of the interval, which comprises almost three quarters, is one of harmony between the lending activities of the industry and the efforts of the Bank of Canada. Total outstandings rose altogether by $90 million, because new loans rose by a total of $350 million. Even though the level of new loans decreased during the middle quarter it still remained above that of repayments, which also declined. The lending activities of the banks strongly reflected the expansionary efforts of the central bank. Total general loans increased by some $1.5 billion, and there also occurred a large increase, of the order of $500 million, in their loans to individuals.

Summary and Conclusions of Chapter IV

The over-riding implications of the foregoing discussion give substance to Mr. Coyne's allegation that the sales finance industry was a destabilizing force that tended to oppose the general designs of the Bank of Canada during the years under review. It is highly probable that the industry's "subversive" impact on the level of spending was quantitatively greater when the economy operated below capacity than when boom conditions prevailed. But, given the Bank's preoccupation with the perils of inflation, it is understandable that it was the industry's behaviour during boom times that most aroused its anxiety.

Secondary implications emerging from this chapter have the effect of disabusing us of simplistic notions concerning the cyclical role of monetary policy. We observed, for example, that while it is true in a general way that the Bank of Canada tended to lean against the trend of the overall level of economic activity during these years, there were several occasions when it did not.[21] Moreover, the intensity of its contracyclical efforts varied a good deal. We also observed that although the industry's balances-outstanding indicator usually tended

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[21]This is one of the several interesting conclusions reached by Johnson and Winder (op. cit.). It implies that the Bank of Canada pursued a variety of goals during these years, of which economic stability was not necessarily the most important.

to oppose the thrust of monetary policy, this was somewhat less true of its new-loans-extended indicator. In any case, it is evident that the behaviour of the balances-outstanding indicator does not by itself fully reveal the inner mechanism which produces its impact on the economy, and therefore the movements of its two constituents are also relevant.[22] We further observed that the industry's activities are governed by strong seasonal forces, as well as by the business cycle. Although the latter tends in itself to promote conflict between the industry's impact on the economy and that of the Bank of Canada, the former constitute largely independent factors. They thus complicate the short-run relationship between the industry's influence and that of the Bank, sometimes increasing existing disharmony and sometimes mitigating it.

It further emerged that other suppliers of consumer credit also tended to oppose the thrust of monetary policy during these years, and that their collective "subversive" impact was probably appreciable. The behaviour of the banks during the latter part of the 'fifties was particularly noteworthy. They were able to greatly expand their lendings to consumers, partly because they had the capacity, as the

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[22]This consideration is of interest not only because of the importance of the new-loans-extended indicator to the movements of the balances-outstanding indicator, but also because it raises the possibility that a monetary authority considering selective action against the industry might time its action unoptimally if it reacted only to the behaviour of the latter. Indeed, the industry suggested to the Porter Commission that this is in fact what happened in the mid-'fifties, when the Bank of Canada avowedly ordered restrictions in bank loans to sales finance companies. (FCSFC, p. 99.)

Porter Commission observed, of liquidating other assets, and partly because the contraction of their advances to sales finance companies tended to open up a gap which they were in a position to fill.

CHAPTER V

THE IMPACT OF MONETARY POLICY ON THE CANADIAN SALES FINANCE INDUSTRY; 1953-1962

Developments within the Industry as a Whole

The response of the Canadian sales finance industry to monetary policy during these years, in both its general and specific forms, was part of its response to the overall concurrent Canadian economic experience. It is therefore necessary to examine the latter in order to discern the former. The industry, however, is an extremely concentrated one and its collective response was largely the aggregate of the individual responses of its dominant members. For this reason we will begin by considering the industry as a whole.[1] Then we will turn to its three largest members, who account for about two-thirds of its business.

Table V-1 gives the industry's balance sheet figures for the nine years beginning in 1953 and ending in 1961, and Table V-2 shows the percentages that these figures form of total assets and total assets plus shareholders' equity respectively. We note, to begin with, that total assets deployed in 1961 amounted to over 1.5 billion dollars, an amount

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[1]The data used below to reflect the industry's experience actually refer to the ten largest companies. However, since this group does about 95% of the industry's lending and holds an equivalent proportion of its assets, it may be regarded as synonymous with the industry.

TABLE V-1

BALANCE SHEET DATA OF THE TEN LARGEST SALES FINANCE COMPANIES
FISCAL YEAR END, 1953-1961, THOUSANDS OF DOLLARS

ASSETS:	1953	1954	1955	1956	1957	1958	1959	1960	1961
Cash	26,944	27,488	19,836	27,829	42,182	32,950	40,894	31,104	31,608
Marketable securities				26	106	16,219	85,024	95,005	71,303
Notes and accounts receivable:									
Retail	645,503	602,743	708,220	940,879	967,246	916,733	1,029,269	1,111,270	1,060,551
Wholesale	135,216	101,375	145,786	199,341	205,086	198,840	201,799	237,032	195,496
Real estate loans	10	22	13	25		29	139	99	106
Capital loans to dealers	2,866	3,422	5,334	5,813	6,419	7,070	8,438	10,968	14,035
Sundry accounts receivable	2,090	3,719	3,585	3,701	4,942	3,684	4,733	6,876	5,177
Total receivables	794,685	711,281	862,938	1,149,759	1,183,693	1,126,356	1,244,378	1,366,245	1,275,365
Less: Provision for doubtful accounts	8,384	8,079	9,210	10,981	11,960	12,060	13,208	14,064	14,826
Net receivables	786,301	703,202	853,728	1,138,778	1,171,733	1,114,296	1,231,170	1,352,181	1,260,539
Investments in:									
Subsidiary companies	18,240	25,613	31,842	47,266	56,017	59,468	88,773	128,828	192,754
Associated companies	1	1	0	650	598	621	1,714	4,851	9,423
Investment in fixed assets to produce rental income			232	373	315	387	364	345	1,095
Fixed assets	3,283	3,210	3,453	4,160	4,555	4,642	4,970	4,942	5,186
Leasehold improvements	256	339	402	431	519	583	604	666	784
Unamortized cost of acquisition of borrowed money	2,389	2,630	2,386	3,517	7,229	4,904	6,811	7,453	6,937
Other assets	1,209	1,492	1,651	1,007	2,713	2,713	2,751	2,614	2,328
TOTAL ASSETS	838,623	763,975	913,530	1,224,037	1,285,866	1,236,783	1,463,075	1,627,989	1,581,957

TABLE V-1 (Continued)

	1953	1954	1955	1956	1957	1958	1959	1960	1961
LIABILITIES:									
Bank borrowings	191,124	103,916	172,419	242,576	155,855	182,269	194,359	163,340	109,031
Other demand loans					681	470	3,852	996	425
Short term notes	211,976	167,352	237,245	330,753	409,333	295,516	424,227	489,132	409,043
Long term notes - more than 2 years to maturity when issued	139,847	156,216	155,790	198,323	227,328	231,448	276,204	336,019	375,800
Bonds and debentures	104,117	128,756	124,991	153,856	192,869	199,516	208,530	250,840	264,534
Total debt	647,064	556,240	690,445	925,508	986,066	909,219	1,107,172	1,240,327	1,158,913
Accounts payable	28,470	30,407	22,649	41,869	32,077	38,326	32,509	39,874	58,530
Dealers' credit balances	32,970	33,855	36,211	43,485	46,243	44,411	44,401	42,457	39,538
Advances from parent or associated companies	5,560	5,000		6,102			10,000	10,000	11,000
Other liabilities	157	123	128	209	2,278	1,212	1,363	1,428	1,746
Unearned service charges	40,761	40,401	50,356	68,800	76,595	78,273	92,824	104,050	98,129
Shareholders' equity:									
Preferred stock	17,989	18,651	19,867	30,167	29,650	34,892	35,138	34,551	40,014
Common stock	37,194	46,179	56,520	64,252	62,183	65,487	68,304	74,104	83,708
Capital surplus	354	402	-	238	679	1,205	1,520	1,941	2,364
Earned surplus	28,104	32,717	37,354	43,407	50,095	63,508	69,344	78,536	87,020
Contingent reserves						250	500	721	995
TOTAL LIABILITIES AND CAPITAL	838,623	763,975	913,530	1,224,037	1,285,866	1,236,783	1,463,075	1,627,989	1,581,957

Source: Federated Council of Sales Finance Companies.

TABLE V-2

BALANCE SHEET DATA OF THE TEN LARGEST SALES FINANCE COMPANIES
FISCAL YEAR END, 1953-1961, PERCENTAGE DISTRIBUTION

	1953	1954	1955	1956	1957	1958	1959	1960	1961
ASSETS:									
Cash	3.21	3.60	2.17	2.27	3.28	2.66	2.80	1.91	2.00
Marketable securities					.01	1.31	5.81	5.84	4.50
Notes and accounts receivable:									
Retail	78.04	78.89	77.53	76.87	75.22	74.12	70.35	68.26	67.04
Wholesale	16.12	13.27	15.96	16.29	15.95	16.08	13.79	14.56	12.36
Real estate loans							.01	.01	.01
Capital loans to dealers	.34	.45	.58	.48	.50	.57	.58	.67	.89
Sundry accounts receivable	.25	.49	.39	.30	.39	.30	.32	.42	.33
Total receivables	94.76	93.10	94.46	93.94	92.06	91.07	85.05	83.92	80.63
Less: Provision for doubtful accounts	1.00	1.06	1.01	.90	.93	.98	.90	.86	.94
Net receivables	93.76	92.04	93.45	93.04	91.13	90.09	84.15	83.06	79.69
Investments in:									
Subsidiary companies	2.18	3.35	3.49	3.86	4.36	4.81	6.07	7.91	12.18
Associated companies				.05	.05	.05	.12	.30	.59
Investment in fixed assets to produce rental income			.03	.03	.03	.03	.02	.02	.07
Fixed assets	.39	.42	.38	.34	.35	.38	.34	.30	.33
Leasehold improvements	.03	.04	.04	.04	.04	.05	.04	.04	.05
Unamortized cost of acquisition of borrowed money	.29	.35	.26	.29	.56	.40	.46	.46	.44
Other assets	.15	.20	.18	.08	.20	.22	.19	.16	.15
TOTAL ASSETS	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

TABLE V-2 (Continued)

	1953	1954	1955	1956	1957	1958	1959	1960	1961
LIABILITIES:									
Bank borrowings	22.79	13.60	18.87	19.82	12.12	14.74	13.29	10.03	6.89
Other demand loans					.05	.04	.26	.06	.03
Short term notes	25.28	21.91	25.97	27.02	31.83	23.89	29.00	30.05	25.86
Long term notes - more than 2 years to maturity when issued	16.68	20.45	17.05	16.20	17.68	18.71	18.88	20.64	23.76
Bonds and debentures	12.41	16.85	13.68	12.57	15.00	16.13	14.25	15.41	16.72
Total debt	77.16	72.81	75.57	75.61	76.68	73.51	75.68	76.19	73.26
Accounts payable	3.39	3.98	2.48	3.42	2.49	3.10	2.22	2.45	3.70
Dealers' credit balances	3.93	4.43	3.96	3.55	3.60	3.59	3.04	2.61	2.50
Advances from parent or associated companies	.66	.65	-	.50	-	-	.68	.61	.70
Other liabilities	.02	.02	.02	.02	.18	.10	.09	.09	.11
Unearned service charges	4.86	5.29	5.51	5.62	5.96	6.33	6.35	6.39	6.20
TOTAL LIABILITIES	92.02	87.18	87.54	88.72	88.91	86.63	88.06	88.34	86.47
	1953	1954	1955	1956	1957	1958	1959	1960	1961
SHAREHOLDERS' EQUITY:									
Preferred stock	2.15	2.44	2.18	2.46	2.31	2.82	2.40	2.12	2.53
Common stock	4.44	6.05	6.19	5.25	4.84	5.30	4.67	4.55	5.29
Capital surplus	.04	.05	-	.02	.05	.10	.10	.12	.15
Earned surplus	3.35	4.28	4.09	3.55	3.89	5.13	4.74	4.82	5.50
Contingent reserves	-	-	-	-	-	.02	.03	.05	.06
TOTAL SHAREHOLDERS' EQUITY	9.98	12.82	14.46	11.28	11.09	13.37	11.94	11.66	13.57
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Federated Council of Sales Finance Companies.

that is nearly double that of eight years earlier. The overwhelmingly important asset category is, of course, the receivables, with investments in subsidiary and associated companies a still relatively minor but rapidly growing second category. Within the receivables grouping itself, the changes suggest a diminishing relative involvement on the part of the industry with wholesale paper coupled with an apparently increasing tendency to finance dealer physical expansion. The advent, in the late 'fifties, of marketable securities as an asset of note, especially in absolute terms, is also of definite interest.

On the liabilities and shareholders' equity side, there is the striking decline in the industry's dependence on bank credit to be noted, along with its increasing reliance on long-term borrowing. It is also interesting to observe that the group's recourse to equity financing increased slightly, with most of the increase occurring in the issues of common stock. This is not altogether what we would have expected, given the relatively irredeemable nature of this type of security. The Tables also indicate a certain tendency on the part of the industry to retain more profits internally, rather than distribute them to shareholders.

Table V-3 gives, in effect, the overall changes in these balance sheet items over the interval, in both absolute and relative terms. Perhaps its most interesting feature is the fact that the firms, as a group, derived 71.4% of their funds from borrowing but applied only 57.7% to lending. This suggests that they chose to use debt rather than equity money to finance such things as outlays for subsidiary and

TABLE V-3

NET SOURCES AND DISPOSITION OF FUNDS OF THE TEN LARGEST SALES FINANCE COMPANIES, DECEMBER 31, 1953 - DECEMBER 31, 1961

Sources of Funds:	Millions of $	% of Total
Long term notes	236	28.4
Short term notes	197	23.7
Bonds and debentures	160	19.3
Total debt	593	71.4
Provision for doubtful accounts	6	0.7
Accounts payable	30	3.6
Dealers' credit balances	6	0.7
Advances from parent companies	5	0.6
Unearned service charges	57	6.9
Other liabilities	1	0.1
Preferred stock	22	2.6
Common stock	49	5.9
Capital surplus	2	0.2
Earned surplus	59	7.1
Contingent reserves	1	0.1
Total equity	133	28.6
GRAND TOTAL:	831	100.0

Disposition of Funds:	Millions of $	% of Total
Cash	5	0.6
Marketable securities	71	8.5
Notes receivable:		
Retail	406	48.8
Wholesale	60	7.2
Capital loans to dealers	11	1.3
Sundry accounts receivable	3	0.4
Total notes receivable	480	57.7
Investment in subsidiary companies	175	21.1
Advances to affiliated companies	9	1.1
All other assets	9	1.1
Bank borrowings	82	9.9
GRAND TOTAL:	831	100.0

Source: Federated Council of Sales Finance Companies.

affiliated companies. It is, however, true that the gap between borrowing inflows and lending outflows is more than offset by expenditures on marketable securities and retirement of bank loans previously incurred. That implies that there was no necessary loss of liquidity in this overall allocation of funds.

The changes that occurred within the sub-intervals of the period under review are of greater relevance to this study. Table V-4 shows the changes in the industry's balance sheet items over the interval, broken down by years. Now an annual distribution for a group such as this, with different fiscal year-end dates (to say nothing of significantly different operating situations, etc.), bears no more than a rudimentary and somewhat fortuitous resemblance to the events that concern us primarily, but a few overall tendencies can be usefully observed. We note, for example, the striking contraction in the industry's use of bank credit during 1956-57 and its accompanying increase in long-term borrowing. These of course reflect the industry's response to the selective action taken against it by the banks at the behest of the Bank of Canada.

Table V-5 places the industry's experience with bank credit into sharper focus. It gives, in particular, the magnitudes of the contractions of both the mid and the late-'fifties. The fact that the Canadian economy is not a closed one, especially in terms of capital inflows from the United States, is conveyed rather vividly by Table V-6. More specifically, it shows that the industry did substantial long-term borrowing in the United States during the late-'fifties.

TABLE V-4

SOURCES AND DISPOSITION OF FUNDS OF THE TEN LARGEST
SALES FINANCE COMPANIES, 1954-1961
(millions of dollars)

Sources (or Disposition):	1954	1955	1956	1957	1958	1959	1960	1961	Total 1954-1961
Cash	(1)	8	(8)	(14)	9	(8)	10	(1)	(5)
Marketable securities					(16)	(69)	(10)	24	(71)
Notes receivable:									
Retail	52	(106)	(233)	(26)	51	(113)	(82)	51	(406)
Wholesale	34	(44)	(53)	(6)	6	(3)	(35)	42	(60)
Real estate loans (a)									
Capital loans to dealers	(1)	(2)	(a)	(1)	(1)	(1)	(3)	(3)	(11)
Sundry accounts receivable	(2)	(a)	(a)	(1)	1	(1)	(2)	2	(3)
Total notes receivable	83	(152)	(286)	(34)	57	(118)	(122)	92	(480)
Investment in subsidiary companies	(7)	(6)	(15)	(9)	(3)	(29)	(40)	(64)	(175)
Advances to affiliated companies	(a)	(a)	(1)	(a)	(a)	(1)	(3)	(3)	(9)
All other assets			(2)	(6)	2	(2)	(1)		(9)
Provision for doubtful accounts	(a)	1	2	1	(a)	1	1	1	6
Bank borrowings	(87)	69	70	(87)	26	12	(31)	(54)	(82)
Other demand loans				1	(a)	3	(3)	1	2
Short term notes	(45)	70	93	78	(114)	129	65	(80)	197
Long term notes	16	(a)	42	29	4	45	60	40	236
Bonds and debentures	25	(4)	29	39	7	9	42	14	160
Accounts payable	2	(8)	19	(10)	6	(6)	7	19	30
Dealers' credit balances	1	2	7	3	(2)	(a)	(2)	(3)	6
Advances from parent companies	(1)	(5)	6	(6)	-	10	-	-	5
Other liabilities	(a)	(a)	(a)	2	(1)	(a)	(a)	(a)	1
Unearned service charges	(a)	10	18	8	2	15	11	(6)	57
Preferred stock	1	1	10	(1)	5	(a)	(1)	4	19
Common stock	8	11	6	2	3	3	6	10	49
Capital surplus	(a)	(a)	(a)	(a)	1	(a)	(a)	1	2
Earned surplus	5	5	6	7	13	6	9	9	59
Contingent reserves					(a)	(a)	(a)	(a)	1

(a) less than $500,000.

Individual items will not add to totals because of rounding. Columns may not add to zero because of rounding.

Source: Federated Council of Sales Finance Companies.

TABLE V-5

LINES AND UTILIZATION OF BANK CREDIT BY THE TEN LARGEST SALES FINANCE COMPANIES, QUARTERLY 1953-1961
(millions of dollars)

	1953				1954				1955			
End of Quarter	I	II	III	IV	I	II	III	IV	I	II	III	IV
Authorized	249	251	270	279	279	293	293	294	301	324	332	334
Utilized	136	199	189	179	131	102	84	96	94	147	143	173
Unused	113	52	81	100	148	191	209	198	207	177	189	160

	1956				1957				1958			
End of Quarter	I	II	III	IV	I	II	III	IV	I	II	III	IV
Authorized	317	312	312	279	265	265	266	267	334	349	382	378
Utilized	149	216	184	227	201	201	183	139	131	125	102	162
Unused	168	96	128	52	64	64	83	128	203	224	280	216

	1959				1960				1961			
End of Quarter	I	II	III	IV	I	II	III	IV	I	II	III	IV
Authorized	388	282	203	198	194	195	188	210	214	229	231	233
Utilized	186	145	175	184	177	170	129	156	109	102	77	96
Unused	202	137	28	14	17	25	59	54	105	127	154	137

Source: Federated Council of Sales Finance Companies.

TABLE V-6

FOREIGN AND DOMESTIC SOURCES OF FUNDS OF THE TEN LARGEST SALES FINANCE COMPANIES, 1953-1961, MILLIONS OF DOLLARS (IN CANADIAN FUNDS)

	1953	1954	1955	1956	1957	1958	1959	1960	1961
1. Bank Loans Outstanding									
In Canada	190	103	171	242	155	178	178	146	95
In U.S.	1	1	1	1	1	4	16	17	14
Other Foreign Countries	-	-	-	-	-	-	-	-	-
Total Outstanding	191	104	172	243	156	182	194	163	109
2. Short Term Notes Outstanding									
Sold in Canada	198	151	228	314	387	279	392	413	323
Sold in U.S.	13	15	8	11	15	12	23	62	84
Sold in Other Foreign Countries	1	1	1	6	7	5	9	14	2
Total Outstanding	212	167	237	331	409	296	424	489	409
3. Long Term Notes and Debentures Outstanding									
Sold in Canada	214	252	248	299	341	348	381	455	494
Sold in U.S.	30	33	33	53	79	83	104	132	146
Sold in Other Foreign Countries	-	-	-	-	-	-	-	-	-
Total Outstanding	244	285	281	352	420	431	485	587	640
4. Common Stock Outstanding									
Sold in Canada	32	38	48	54	55	57	60	63	73
Sold in U.S.	3	4	4	4	5	6	6	8	8
Sold in Other Foreign Countries	-	1	2	2	2	2	2	3	3
Total Outstanding	35	43	54	60	62	65	68	74	84
5. Preferred Stock Outstanding									
Sold in Canada	18	19	20	30	30	32	32	32	37
Sold in U.S.	-	(a)	-	(a)	(a)	3	3	3	3
Sold in Other Foreign Countries	-	-	-	-	-	-	-	-	-
Total Outstanding	18	19	20	30	30	35	35	35	40
6. Advances from Parent or Subsidiaries									
In Canada	-	-	-	-	-	-	-	-	-
In U.S.	6	5	-	6	-	-	10	10	11
In Other Foreign Countries	-	-	-	-	-	-	-	-	-
Total Outstanding	6	5	-	6	-	-	10	10	11

(a) Less than $500,000.

Source: Federated Council of Sales Finance Companies.

Table V-7 shows the industry's earnings during the review period, both in absolute terms and as a percentage of total gross revenues. Perhaps the most striking feature to be noted here, apart from the massive growth in the volume of business, is the consistent diversification of the industry's revenue sources. Another significant feature is the increased cost of the industry's borrowing. This, of course, reflects the fact that the industry was steadily forced to turn to nonbank lenders during the latter part of the period. Its rates of profit contracted significantly as a result, although as was noted above, they still remained at a relatively high level.[2] The fundamental cause of this downward pressure on the industry's profit rates under conditions of expanding lending volumes was the generally narrowing spread between the rates of interest its members were able to earn on their loans and those they found it necessary to pay on their borrowings.[3] During the

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[2]It should be noted that there are many difficulties in computing the profits of sales finance companies. These stem basically from the fact that when a sales finance company computes its earnings for a given fiscal period it must make provision for that portion of its current accounts receivable that will ultimately prove to be uncollectible, and for other contingencies. Since no definitively scientific method of measuring these contingencies exists, or can exist, different companies inevitably assess them differently. As a result, not only do the profit figures of the various companies have somewhat different meanings for any given fiscal period, but, as will be seen below in the case of Traders Finance, they may also have different meanings for the same company for different fiscal periods.

[3]Another factor that has militated in the direction of lower profit rates for sales finance companies is the tendency, that began in the mid-'fifties, for repayment intervals of the various kinds of loans that they extend to lengthen. This tendency is indicated clearly on Table V-10 and Table V-11, and corresponds to the experience of the American sales finance industry. It is apparently unrelated to the effects of monetary policy. (See McCracken, Mao, and Fricke, op. cit., passim.)

TABLE V-7

EARNINGS OF THE TEN LARGEST SALES FINANCE COMPANIES
1953-1961, THOUSANDS OF DOLLARS

	1953		1954		1955	
	000$	%	000$	%	000$	%
Earnings:						
Retail finance charges	66,350	86.3	68,318	84.7	69,722	87.2
Wholesale finance charges (a)	8,805	11.4	9,236	11.4	7,621	9.5
Income from real estate loans						
Income from capital loans to dealers	141	0.2	162	0.2	219	0.3
Dividends and interest on investments			51	0.2		
Dividends and interest from associated companies						
Dividends and interest from subsidiary companies:						
Small loan	508	0.6	624	0.8	854	1.1
Insurance	130	0.2	911	1.1	189	0.2
Other	85	0.1	155	0.2	146	0.2
Miscellaneous income	925	1.2	1,244	1.5	1,203	1.5
Total gross earnings:	77,124	100.0	80,701	100.0	79,954	100.0
Expenses:						
Interest on loans and funded debt	23,688	30.7	24,344	30.2	21,529	26.9
Cost of acquisition of borrowed money	1,342	1.7	1,269	1.6	509	0.7
Provision for losses	2,928	3.8	3,767	4.6	5,042	6.3
Salaries and wages	12,080	15.7	14,201	17.6	15,216	19.0
Rent, depreciation and other expenses	8,539	11.1	11,321	14.0	10,203	12.8
Earnings before income taxes	28,547	37.0	25,799	32.0	27,455	34.3
Provision for income taxes	15,291	19.8	12,870	16.0	13,265	16.6
Minority interest						
Net earnings after taxes:	13,256	17.2	12,929	16.0	14,190	17.7

TABLE V-7 (Continued)

	1956		1957		1958	
	000$	%	000$	%	000$	%
Earnings:						
Retail finance charges	87,799	85.5	102,268	83.7	102,104	81.6
Wholesale finance charges (a)	10,966	10.7	15,037	12.3	12,446	10.0
Income from real estate loans						
Income from capital loans to dealers	267	0.2	312	0.3	429	0.3
Dividends and interest on investments	165	0.1	232	0.2	114	0.1
Dividends and interest from associated companies	3		4			
Dividends and interest from subsidiary companies:						
Small loan	1,311	1.3	1,774	1.5	7,303	5.8
Insurance	489	0.5	148	0.1	231	0.2
Other	271	0.3	391	0.3	537	0.4
Miscellaneous income	1,464	1.4	1,960	1.6	1,963	1.6
Total gross earnings:	102,735	100.0	122,126	100.0	125,127	100.0
Expenses:						
Interest on loans and funded debt	32,853	32.0	46,445	38.0	41,056	32.8
Cost of acquisition of borrowed money	1,753	1.7	2,498	2.0	1,368	1.1
Provision for losses	5,010	4.9	4,116	3.4	4,528	3.6
Salaries and wages	17,664	17.2	19,667	16.1	21,410	17.1
Rent, depreciation and other expenses	12,138	11.8	14,222	11.7	15,893	12.7
Earnings before income taxes	33,317	32.4	35,178	28.8	40,872	32.7
Provision for income taxes	15,571	15.1	16,393	13.4	18,676	14.9
Minority interest			41		88	0.1
Net earnings after taxes:	17,746	17.3	18,744	15.4	22,108	17.7

TABLE V-7 (Continued)

	1959		1960		1961	
	000$	%	000$	%	000$	%
Earnings:						
Retail finance charges	107,813	81.3	122,462	78.6	122,839	79.1
Wholesale finance charges (a)	14,962	11.3	16,574	10.7	14,032	9.0
Income from real estate loans	5		11		9	
Income from capital loans to dealers	563	0.4	682	0.4	1,073	0.7
Dividends and interest on investments	2,280	1.7	5,113	3.3	3,733	2.4
Dividends and interest from associated companies	50		81	0.1	90	0.1
Dividends and interest from subsidiary companies:						
Small loan	3,673	2.8	6,588	4.2	7,627	4.9
Insurance	282	0.2	330	0.2	243	0.2
Other	698	0.5	999	0.6	1,764	1.1
Miscellaneous income	2,318	1.8	2,905	1.9	3,841	2.5
Total gross earnings:	132,644	100.0	155,745	100.0	155,251	100.0
Expenses:						
Interest on loans and funded debt	49,515	37.3	61,186	39.3	56,864	36.6
Cost of acquisition of borrowed money	1,619	1.2	2,802	1.8	2,448	1.6
Provision for losses	6,168	4.7	6,149	3.9	7,685	5.0
Salaries and wages	21,935	16.5	23,476	15.1	24,407	15.7
Rent, depreciation and other expenses	17,645	13.3	20,203	13.0	19,514	12.6
Earnings before income taxes	35,762	27.0	41,929	26.9	44,333	28.5
Provision for income taxes	17,142	12.9	20,498	13.2	22,088	14.2
Minority interest	68	0.1	61		53	
Net earnings after taxes:	18,552	14.0	21,370	13.7	22,192	14.3

(a) Net, after wholesale insurance.

Source: Federated Council of Sales Finance Companies.

upswing from around the middle of 1955 to the end of 1956, for example, interest rates paid by the industry increased sharply, as Table V-8 shows, while retail finance charges[4] earned by it rose less rapidly, as Table V-9 shows. These Tables reveal a similar tendency for the upswing that began in the Spring of 1958 and continued to the end of 1959, an interval marked by particularly restrictive action towards the industry on the part of the banks. It is also true, however, that during the downswing that lasted from the Spring of 1957 until the Spring of 1958 the rates paid by the industry fell while those it earned remained fairly sticky. A broadly similar tendency was displayed by the market during the downswing of 1959-1960, but on this occasion it appears that retail finance charges were softer than they had been during the previous downswing. (The upward stickiness on the part of the interest rates that the industry as a whole was able to earn--individual companies varied considerably, as Table V-9 indicates--during the upswings cited also raises some doubts as to the generality of the conventional view that the demand for commodity instalment credit is always subject to very high interest inelasticity.)

The other aspect of the overall experience of the industry that left its mark is that events tended, especially during the latter part of the decade, to assume increasingly discriminatory features. We noted in the passages from the 1956 Annual Report of the Governor of the Bank

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[4]This involves more than an interest charge. It also includes an insurance component.

TABLE V-8

INTEREST RATES PAID BY THE TEN LARGEST SALES
FINANCE COMPANIES ON 90-DAY SHORT TERM PAPER
QUARTERLY 1953-1961

End of Quarter:	1953				1954				1955				1956				1957				1958				1959				1960				1961			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
1 3/4							1	1	4	4	1																									
2								3		1	3																									
2 1/4						1	3	2	1	1	3												1													
2 1/2						3																1									4					
2 3/4					1		1						2									6	6								4					
3	1	1	1	1	3	1	1	1	1			7	3								4	1	1								1			7	2	
3 1/4	2	2	2	4	1								1								1	1	1							1				2	6	
3 1/2	2	2	2	1										1							3			6											1	8
3 3/4													1	4										3						1			8		1	1
3 7/8																																				1
4														2	4														6	6		6	1			
4 1/8															1																					
4 1/4															1					1	1				1				1	1		3				
4 3/8																															1					
4 1/2														1						5					6				2			1				
4 3/4															2					1					1								1			
5																2				1					1											
5 1/4																4	5	5	5	1						1										
5 1/2																2	2	2	2							7		6								
5 3/4																	1		1							1		2								
5 7/8																												1								
6																			1								2									
6 1/4																											1									
6 3/8																											2									
6 1/2																		1									4									
Number of Companies Reporting:	5	5	5	6	5	5	6	7	6	6	7	7	7	8	8	8	8	8	9	9	9	9	9	9	9	9	9	9	9	9	10	10	10	9	10	10

Source: Federated Council of Sales Finance Companies.

TABLE V-9

INDEX OF FINANCE CHARGE ON A $2,000 UNPAID BALANCE ON A NEW AUTOMOBILE REPAYABLE OVER 30 MONTHS, 1954-1961, SECOND QUARTER 1954 = 100

Company No:		1	2	3	4	5	6	7
1954	II	100	100 - 100	100	100	100	100	100
	III	100	100 - 100	100	100	100	100	100
	IV	100	100 - 118	100	100	100	100	100
1955	I	100	114 - 118	93	97	100	96	100
	II	100	114 - 118	93	97	100	96	100
	III	100	114 - 118	93	97 - 110	100	96	100
	IV	100	114 - 118	93	97 - 110	100	96	103
1956	I	100	114 - 118	93	97 - 110	100	96	103
	II	103	114 - 118	93	97 - 110	100	99	103
	III	103	114 - 118	93	97 - 100	100	99	103
	IV	103	114 - 126	93	105 - 119	100	99	103
1957	I	110	114 - 126	93	105 - 119	110	99	120
	II	110	114 - 126	93	105 - 119	110	117	120
	III	110	114 - 126	93	105 - 119	110	117	120
	IV	110	114 - 126	93	105 - 119	110	117	120
1958	I	110	114 - 126	107	105 - 119	110	118	120
	II	110	114 - 126	107	105 - 119	110	116	120
	III	110	114 - 126	107	90 - 114	110	116	120
	IV	101	114 - 126	107	90 - 114	110	116	120
1959	I	101	91 - 126	107	90 - 114	121	116	120
	II	101	91 - 126	107	97 - 121	121	116	120
	III	107	91 - 126	107	97 - 121	121	116	128
	IV	107	91 - 126	107	97 - 121	121	116	128
1960	I	83 - 107	91 - 126	107	97 - 121	121	116	128
	II	83 - 107	91 - 126	107	91 - 121	110	116	96 - 128
	III	83 - 107	91 - 126	107	91 - 121	110	116	96 - 128
	IV	83 - 107	91 - 126	107	91 - 121	110	116	96 - 128
1961	I	83 - 107	91 - 126	107	91 - 121	110	116	96 - 128
	II	83 - 107	91 - 126	107	91 - 121	73	116	96 - 128
	III	83 - 107	91 - 126	107	91 - 121	73	116	96 - 128
	IV	83 - 107	91 - 126	107	91 - 121	73	116	96 - 128

Source: Federated Council of Sales Finance Companies.

TABLE V-10

AVERAGE REPAYMENT PERIOD (IN MONTHS) ON OTHER CONSUMER GOODS INSTALMENT CONTRACTS, FOUR SALES FINANCE COMPANIES QUARTERLY 1954-1961

		1	2	3	4
1954	I	16.6		17.0	20
	II	16.4		17.7	19
	III	16.1		17.9	19
	IV	16.1		18.1	19
1955	I	15.9		18.3	19
	II	15.8		18.5	20
	III	16.5		18.5	20
	IV	17.2		18.4	19
1956	I	18.1		18.4	20
	II	17.4		18.4	20
	III	16.9		18.3	18
	IV	17.4		18.1	19
1957	I	17.3		17.8	18
	II	16.5		18.2	18
	III	17.8		18.1	18
	IV	16.7	16.5	17.8	18
1958	I	16.1	16.5	17.8	18
	II	16.0	16.8	17.9	19
	III	16.0	17.6	18.0	19
	IV	16.9	17.0	17.8	20
1959	I	16.4	16.4	17.8	19
	II	17.1	16.7	17.9	19
	III	17.5	17.5	19.2	19
	IV	17.7	17.3	18.3	19
1960	I	17.1	18.3	18.0	20
	II	17.4	17.6	18.7	20
	III	17.6	18.2	18.4	21
	IV	17.4	18.7	19.1	20
1961	I	17.7	18.3	17.6	19
	II	17.6	18.2	18.0	20
	III	18.4	18.2	18.4	21
	IV	18.4	18.1	17.9	20
Change: 1954-1961 (No. of months)		+1.8	+1.6*	+0.9	-

* IV/1957 to IV/1961

Source: Federated Council of Sales Finance Companies.

TABLE V-11

AVERAGE REPAYMENT PERIOD (IN MONTHS) ON NEW AUTOMOBILE INSTALMENT CONTRACTS, FOUR SALES FINANCE COMPANIES QUARTERLY 1954-1961

		1	2	3	4
1954	I	21.5		19.1	20.0
	II	21.7		19.9	20.6
	III	22.8		20.9	21.1
	IV	22.5		20.4	21.3
1955	I	22.0		22.2	21.2
	II	23.0		23.3	22.0
	III	24.0		23.9	23.7
	IV	23.7		23.1	23.7
1956	I	24.3		24.3	22.9
	II	24.6		24.1	23.1
	III	25.2		24.6	23.6
	IV	24.4		23.5	22.8
1957	I	23.4		23.6	21.5
	II	24.1		24.4	22.5
	III	25.4		25.3	24.0
	IV	25.1	24.8	24.2	23.4
1958	I	24.6	24.4	24.9	22.1
	II	25.1	26.5	25.2	23.2
	III	25.6	26.8	25.5	23.9
	IV	25.8	27.5	24.5	23.5
1959	I	25.7	26.5	25.5	23.5
	II	26.2	27.2	26.2	23.9
	III	27.2	28.3	26.7	24.8
	IV	26.8	28.5	25.3	23.8
1960	I	26.4	27.8	25.5	24.0
	II	27.1	28.7	26.3	25.1
	III	28.0	29.4	27.0	26.0
	IV	27.4	29.0	25.2	25.2
1961	I	27.2	27.9	25.8	25.2
	II	28.0	29.3	27.0	26.0
	III	28.6	29.8	27.7	26.9
	IV	28.1	29.8	26.3	26.4
Change: 1954-1961 (No. of months)		+6.6	+5.0*	+7.2	+6.4

* IV/1957 to IV/1961

Source: Federated Council of Sales Finance Companies.

of Canada that were cited earlier a distinct tendency to attribute a unique behavioural pattern to commodity instalment credit. This pattern was, in fact, not unique to it but shared, to at least a substantial degree, by all forms of consumer credit, as was seen above in some detail. What is significant here, however, is the fact that it was probably this attitude that led the Bank of Canada in 1959 to either require or allow the chartered banks to withdraw large portions of the credit they had previously authorized for the sales finance industry while, apparently, permitting them to honour commitments to other, partly analogous, purveyors of credit. Nor, as we know, did the Bank prevent the banks from simultaneously expanding their own loans for the acquisition of automobiles and, to a lesser degree, for the acquisition of other consumer durables. Indeed, we have reason to believe that it actually welcomed this development. This experience may very well have contributed to a feeling among some members of the sales finance industry that the central bank had singled them out to their competitive disadvantage, and that the time had therefore arrived for the exploration of wider horizons. These considerations and their implications will be taken up further in the last chapter.

Developments within Industrial Acceptance Corporation Limited

The foregoing discussion was concerned with the major developments that occurred within the structure and *modus operandi* of the Canadian sales finance industry as a whole since the early 'fifties. This was useful as a means of deepening our perspectives, but now it is desirable to look at these and related phenomena in narrower focus. As was pointed out above, we are dealing with an industry which, even by the standards of Canada's financial intermediaries, is a very highly concentrated one indeed. The field is dominated, as we know, by three enormous firms. Two of these may be termed "general" sales finance companies, while the remaining one is altogether a special case.

The larger of the "general" sales finance companies, and also the largest of the three, is Industrial Acceptance Corporation Limited. Although rather an "old" company, as Canadian sales finance companies go (it was established in 1925) it, like the rest of the industry, was relatively insignificant in size until the post-war period. Since then, its growth has been remarkable, as Table V-12 reveals in some detail.[5]

Table V-13 compares the condensed consolidated balance sheet of IAC as at the end of 1950 with that as at the end of 1961; and is intended to convey not only the overall changes in the various asset and liability categories during these eleven years, but also the changes in the Company's financial structure that occurred over the interval.[6]

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[5]It should be pointed out that this Table and, indeed, most of the data referred to below concern the consolidated affairs of the Company, and therefore extends considerably beyond its operations in the field of commodity instalment credit. This field, however, has always been overwhelmingly its primary raison d'être. It is therefore unlikely that the main purposes for which these data will be used, to indicate tendencies and changes in relative terms, are materially affected, although, clearly, the absolute figures should be read with this consideration in mind.

[6]The year 1961 marked an important watershed in the development of the Company. It saw IAC embark upon an extensive programme of diversification in its operations. The result is that there is no necessary

TABLE V-12

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED
SUMMARY OF GROWTH, 1950-1961

	Total Assets (Million$) (Year-End)	Total Shareholders' Equity (Million$) (Year-End)	Total Debt (Million$) (Year-End)	Gross Income (Million$)	Net Earnings (Million$)	Volume of Business (Million$)	Net Receivables (Million$) (Year-End)
1950	145.1	14.7	113.1	16.9	2.8	397.9	139.2
1951	162.9	16.2	129.4	22.1	3.0	422.2	148.6
1952	263.2	27.0	202.2	30.3	5.0	574.7	249.0
1953	308.9	37.6	229.3	42.4	7.0	609.9	287.8
1954	268.3	41.0	187.5	39.5	6.8	464.1	245.6
1955	349.0	51.8	251.3	40.1	7.4	636.9	331.6
1956	448.3	65.1	323.2	51.7	8.6	795.6	429.3
1957	460.1	68.9	329.4	58.5	9.2	712.4	433.7
1958	474.8	74.8	333.2	60.5	10.7	716.9	436.9
1959	567.2	81.0	411.4	68.5	10.9	825.0	486.1
1960	626.9	88.3	454.4	80.8	12.1	847.3	540.0
1961	606.6	96.2	427.9	84.4	12.5	795.0	525.7

Source: Industrial Acceptance Corporation Limited.

TABLE V-13

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED

CONDENSED CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 1950 AND DECEMBER 31, 1961

	December 31					
	1950		1961		Per $100 Equity	
	000$	% of total	000$	% of total	1950	1961
ASSETS						
Cash	2,507	1.73	7,817	1.29	17.09	8.12
Marketable Securities	2,322	1.60	66,533	10.97	15.83	69.13
Total: Cash and Marketable Securities	4,829	3.33	74,350	12.26	32.92	77.26
Receivables:						
Retail	105,494	72.71	376,292	62.03	719.01	390.99
Wholesale	30,239	20.84	54,390	8.97	206.10	56.51
Direct Consumer Loans	4,545	3.13	92,456	15.24	30.98	96.07
Other Instalment Paper	794	.55	9,855	1.62	5.41	10.24
Sundry Accounts Receivable	400	.28	665	.11	2.73	.69
Total Receivables	141,472	97.51	533,658	87.98	964.23	554.50
Less: Reserve for Losses	(2,382)	(1.64)	(8,262)	(1.36)	(16.23)	(8.59)
	139,090	95.87	525,396	86.61	948.00	545.92
Total Circulating Assets	143,919	99.20	599,746	98.87	980.91	623.17
Other Assets	1,167	.80	6,845	1.13	7.95	7.11
TOTAL	145,086	100.00	606,591	100.00	988.86	630.28

TABLE V-13 (Continued)

	December 31					
	1950		1961		Per $100 Equity	
	000$	% of total	000$	% of total	1950	1961
LIABILITIES						
Accounts Payable, Income Taxes Payable and Dealers' Credit Balances	8,129	5.60	30,247	4.99	55.40	31.43
Unearned Service Charges	9,219	6.35	52,243	8.61	62.83	54.28
Notes and Debentures:						
Secured demand and short term notes	53,066	36.58	201,132	33.16	361.68	208.99
Secured term notes	50,000	34.46	145,845	24.04	340.79	151.54
Total senior debt	103,066	71.04	346,977	57.20	702.47	360.53
Debentures	10,000	6.89	80,883	13.33	68.16	84.04
Total debt	113,066	77.93	427,860	70.53	770.63	444.57
Equity:						
Preferred stock	5,080	3.50	17,635	2.91	34.62	18.32
Common stock	4,048	2.79	28,785	4.75	27.59	29.91
Capital Surplus			1,941	.32		2.02
Retained earnings	5,544	3.82	47,880	7.89	37.79	49.75
Total Equity	14,672	10.11	96,241	15.87	100.00	100.00
TOTAL	145,086	100.00	606,591	100.00	988.86	630.28

Source: Industrial Acceptance Corporation Limited.

Before proceeding any further, it should be noted that at the end of the 1961 fiscal year IAC had a number of subsidiaries, of which two, both wholly-owned, were material to its overall operations up to that point. The larger of these, Niagara Finance Company Limited, was then (and remains) one of the largest consumer loan companies in Canada. The other, Merit Insurance Company, is a quite large firm which insures the various types of merchandise financed by IAC, mainly but by no means entirely in conjunction with IAC's lending operations.

Looking at Table V-13, we are immediately struck by the extraordinary increase in the Company's holdings of marketable securities; from a total of 2.3 million dollars in 1950 to a total of 66.5 millions in 1961. A further sense of the extent of this change is gained from the fact that, whereas in 1950, marketable securities amounted to 1.6% of total assets, they represented 11% in 1961. This observation brings us into explicit contact, for the first time, with the question of liquidity, as it pertains to an individual sales finance company. It is obvious that, however one wishes to define liquidity in the abstract, IAC's operational attitude on the subject underwent drastic revision during the eleven years under review. To perceive this, one has only to contrast the percentage that the sum of cash plus marketable

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continuity in the Company's policies. This, needless to say, does not mean that its characteristics and behaviour during the earlier period are irrelevant to those of the later one, even when the discontinuity seems most pronounced. It means, rather, that the elementary requirement that a given institution's activities must always be examined within an appropriately contemporaneous context applies with more than usual force.

securities bore to the Company's total assets in 1950, 3.3%, to the corresponding percentage in 1961, namely 12.3%. Nor was the change sudden, as a glance at Table V-14 will show: the increase is spread over the entire period, though unevenly.

A similar process is visible on Table V-13, in the relative composition of the Company's receivables. In 1950, loans on sales at retail represented 72.2% of its total receivables: by 1961, this percentage had declined to 62%. The decline was even more substantial in the case of loans for automobile dealers' inventories--the so-called "wholesale" loans. In 1950, they represented 20.8% of total receivables, but by 1961 this percentage had shrunk to 9%. Direct consumer loans (made through Niagara Finance Company), varied, however, very differently indeed. Whereas these represented a mere 3.1% of total assets in 1950, they had expanded to 15.2% by 1961. Here, too, the evolution is distributed over the entire period.

The overall structural changes in the Company's liabilities and shareholders' equity were less drastic, but they were not insubstantial. We note, for example, that changes in either profit rates or dividend policies, or in both, had apparently occurred during the years under review, since the Company's retained earnings in 1961 amounted to some $48 millions, or 7.9% of total liabilities plus equity. In 1950, the corresponding figures were $5.5 millions and 3.8% respectively. We also note that the equity section of the balance sheet grew in significance, both in absolute and relative terms. Rather curiously, given the

TABLE V-14

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED

NET FLOW OF FUNDS

Sources of (Disposition)	1951	1952	1953	1954	1955
	(Thousands of Dollars)				
1. Cash	(7,342)	2,416	(4,273)	128	5,666
2. Retail Instalment Paper	(657)	(94,857)	(35,844)	36,168	(44,922)
3. Wholesale Paper	(5,491)	28	204	13,386	(34,876)
4. Direct Sec. Instalment Loans	(3,468)	(6,883)	(3,357)	(4,572)	(5,554)
5. Repossessions	(19)	(171)	(88)	67	85
6. Other Instalment Obligations	(106)	(267)	(153)	(738)	(1,467)
7. Sundry Accounts Receivable	(368)	52	(78)	(1,590)	682
8. Marketable Securities	(1,056)	(2,154)	(538)	(727)	(920)
9. Other Assets	(4)	(138)	(2,092)	(927)	(362)
10. Sec. Demand and Short Term Notes	14,291	68,097	14,380	(59,171)	58,978
11. Accounts Payable and Accrued Liabilities	271	338	1,162	860	(26)
12. Income Taxes	1,019	1,657	462	(683)	(182)
13. Dealers' Credit Balances	-	3,335	3,316	(502)	285
14. Deferred Income	(1,231)	11,266	3,108	(1,920)	6,043
15. Secured Term Notes	-	-	3,326	5,500	6,000
16. Debentures	2,000	4,780	9,320	11,950	(1,246)
17. Res. for Doubtful Receivables	660	1,697	566	(592)	61
18. Preferred Stock	(771)	4,373	4,802	(4,491)	1,004
19. Common Stock	608	3,766	2,604	4,731	6,676
20. Capital Surplus	162	103	66	53	(385)
21. Retained Earnings	1,502	2,541	3,165	3,069	3,570
22. Provision for Dividends on Preferred Stock		22	(22)		

Source: Industrial Acceptance Corporation Limited.

(Thousands of Dollars)

1955	1956	1957	1958	1959	1960	1961	Total 1951 - 1961
5,666	(587)	(7,896)	2,959	(2,591)	3,213	2,109	(5,310)
(44,922)	(93,012)	3,589	5,174	(35,044)	(23,695)	12,302	(270,798)
(34,876)	5,453	(5,532)	2,285	(3,297)	(10,230)	13,919	(24,151)
(5,554)	(9,580)	(2,423)	(11,341)	(11,144)	(18,217)	(11,373)	(87,911)
85	77	(19)	18	(70)	(21)	(42)	(183)
(1,467)	(1,069)	(832)	(308)	(370)	(2,356)	(1,397)	(9,063)
682	263	262	394	(83)	86	115	(265)
(920)	(961)	492	(14,674)	(40,229)	(8,271)	4,828	(64,211)
(362)	(106)	47	8	(272)	(673)	(975)	(5,494)
58,978	51,528	(16,781)	(7,749)	61,284	7,074	(43,866)	148,066
(26)	607	103	594	582	2,725	1,016	8,232
(182)	640	235	1,239	(337)	1,161	420	5,595
285	2,871	601	(329)	(27)	(936)	(322)	8,292
6,043	10,054	749	3,547	7,855	6,359	(2,805)	43,024
6,000	17,405	7,821	7,439	10,291	28,971	9,093	95,845
(1,246)	2,989	15,130	4,136	6,620	6,958	8,246	70,883
61	200	564	730	687	503	803	5,880
1,004	9,762	(441)	(526)	(314)	(421)	(424)	12,555
6,676	49	313	772	963	1,649	2,606	24,737
(385)	238	441	526	314	421	-	1,941
3,570	3,179	3,576	5,105	5,182	5,699	5,746	42,336

comments made earlier about the advantageousness of issuing preferred rather than common stock, the former seems to have lost ground in favour of the latter over the interval; though both increased in absolute terms. This probably reflects imperfections in Canada's capital markets.

Table V-15 gives the Company's aggregate flow of funds over these eleven years. Of the total funds generated during the period, only 52.8% was obtained by means of secured debt. The greater part of the remainder came from the issue of unsecured debt and from both types of stock issues, as well as from retained earnings. (Table V-14 gives a detailed annual breakdown in this flow.) A striking 13.9% of these funds was applied to the purchase of marketable securities over the interval as a whole, and only 58.9% went into the acquisition of retail paper. On the other hand, unprecedentedly large allocations, of the order of 19% of total outlays, were made in the form of direct loans to consumers.

IAC's relations with the chartered banks during this period were inevitably obscured in the foregoing discussion. Table V-16 introduces them, and shows the Company's indebtedness to its bankers at both mid-year and year-end for each of the eleven years under review, together with the respective weighted average interest rates. Setting aside the first and last of these considerations, we note that the relative importance of bank loans to the Company's financial structure was much smaller in 1961 than it had been eleven years earlier. This situation

TABLE V-15

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED, FLOW OF FUNDS
DECEMBER 31, 1950 - DECEMBER 31, 1961

Sources of Funds:	000$	% of Total
Secured demand and short-term notes	148,066	32.09
Secured term notes	95,845	20.77
Debentures	70,883	15.36
Total debt	314,794	68.22
Accounts Payable, Income Tax Payable and Dealers' Credit Balances	22,118	4.79
Unearned Service Charges	43,024	9.32
Preferred stock	12,555	2.72
Common stock	24,737	5.36
Capital surplus	1,941	.42
Retained earnings	42,336	9.17
Total equity	81,569	17.67
Total - sources of funds	461,505	100.00

Application of Funds:	000$	% of Total
Cash	5,310	1.15
Marketable Securities	64,211	13.91
Total Cash and Marketable Securities	69,521	15.07
Receivables:		
Retail	270,798	58.68
Wholesale	24,151	5.23
Direct secured instalment loans	87,911	19.05
Other instalment paper	9,061	1.96
Sundry accounts receivable	265	.06
Total receivables	392,186	84.99
Less: Reserve for losses	(5,880)	(1.27)
Net receivables (earning assets)	386,306	83.71
Total circulating assets	455,827	98.78
Other assets	5,678	1.23
	461,505	100.00

Source: Industrial Acceptance Corporation Limited.

TABLE V-16

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED*

CHARTERED BANK LOANS OUTSTANDING AT MID-YEAR AND YEAR-END AND WEIGHTED AVERAGE INTEREST RATES ON BANK LOANS, 1951-1961

End of	Chartered Bank Loans Outstanding 000$	Weighted Average Interest Rate
1951 - June	63,355	4.5
Dec.	23,155	4.5
1952 - June	48,655	4.5
Dec.	70,505	4.5
1953 - June	81,375	4.5
Dec.	71,850	4.5
1954 - June	48,530	4.5
Dec.	43,920	4.5
1955 - June	79,870	4.5
Dec.	91,500	4.5
1956 - June	85,450	5.0
Dec.	85,575	5.5
1957 - June	76,280	5.5
Dec.	59,445	5.5
1958 - June	80,200	5.25
Dec.	108,150	5.25
1959 - June	75,200	5.75
Dec.	96,650	5.75
1960 - June	98,550	5.75
Dec.	98,350	5.75
1961 - June	65,650	5.65
Dec.	56,100	5.50

* Including Bank loans of subsidiaries.

Source: Industrial Acceptance Corporation Limited.

is, of course, what was to be expected on the basis of what we now know of the industry's experience with the banks during this interval.

As Table V-16 also shows and, again, as might have been expected, the Company's dependence on bank credit underwent drastic changes on various occasions during the interval. This Table combines with Table V-14 to give both IAC's total debt and its bank loans outstanding at fiscal years-end for each year between 1951 and 1961, and confirms this impression in a more detailed fashion. Up to the middle 'fifties, the two variables tended to move in the same direction, but they diverged sharply in 1956. Total debt increased by an almost unprecedented \$71.9 millions, but bank loans were reduced by \$5.9 millions. They diverged again during 1957, when total debt rose by \$6.1 millions while bank loans decreased by \$26 millions. Both the Company's total debt and its bank debt grew during the following year, with the latter increasing by an unprecedented \$48.7 millions and the former a mere \$3.8 millions. But 1959 saw the two variables again diverge violently. Total debt expanded by \$78.2 millions; bank debt fell \$11.5 millions.

IAC's submission to the Porter Commission and statements made in conjunction with it by its executives provide a number of illuminating indications of their rationale of the developments described above. With respect, firstly, to the relationship between debt liabilities and shareholders' equity, we learn that the Company operates on the basis of what is referred to as a "leverage ratio", a term that connotes the ratio between the two variables. Column (9) on Table V-17 gives the Company's

TABLE V-17

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED
DEBT AND SHAREHOLDERS' EQUITY, 1950-1961
000$

	Total Shareholders' Equity	Debentures	(1) + (2) Equity and Debentures	Secured Term Notes	Secured Demand and Short Term Notes	(4) + (5) "Senior Debt"	Ratio of Sr. Debt to Equity and Debentures	(2) + (6) Total Debt	Ratio Total Debt to Equity
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1950	14,672	10,000	24,672	50,000	53,066	103,066	4.18	113,066	7.71
1951	16,174	12,000	28,174	50,000	67,357	117,357	4.17	129,357	8.00
1952	26,957	16,780	43,737	50,000	135,454	185,454	4.24	202,234	7.50
1953	37,594	26,100	63,694	53,326	149,834	203,160	3.19	229,260	6.10
1954	40,957	38,050	79,007	58,826	90,663	149,489	1.89	187,539	4.58
1955	51,825	36,804	88,629	64,826	149,641	214,467	2.42	251,271	4.85
1956	65,053	39,793	104,846	82,231	201,169	283,400	2.70	323,193	4.97
1957	68,942	54,923	123,865	90,051	184,388	274,439	2.22	329,362	4.78
1958	74,819	59,059	133,878	97,490	176,639	274,129	2.05	333,188	4.45
1959	80,965	65,679	146,644	107,781	237,924	345,705	2.36	411,384	5.08
1960	88,313	72,637	160,950	136,752	244,998	381,750	2.37	454,387	5.15
1961	96,241	80,883	177,124	145,845	201,132	346,977	1.96	427,860	4.45

Source: Industrial Acceptance Corporation Limited.

leverage ratios at each of the year-end dates from 1950 to 1961, and shows that they ranged from a high of 8.0 to a low of 4.45, moving on the whole in a downward direction over the interval. Some of the lower ratios are said to have occurred "when the effects of business recession were felt through a reduction in receivables and an accompanying contraction in short-term debt".[7]

A hint is given as to the competitive situation within the Canadian sales finance industry in a reference to IAC's allegedly lower leverage ratio, as compared with similarly "independent" American companies. It, we are told, is imposed on the Company by the operations of certain other Canadian companies which are able to compete more effectively for loanable funds. These firms are able to do this, allegedly, because they are associated with larger organizations. These are primarily manufacturers or distributors, but their greater combined resources enable their sales finance affiliates to present a more attractive face to prospective lenders than can autonomous companies.[8]

The Company's varying sensitivity and reaction, at different times during the review period, to anti-inflationary monetary policy is also intimated. In 1951, it was confronted with consumer instalment credit controls and restricted bank credit, on the one hand, and

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[7] IAC submission to the Royal Commission on Banking and Finance, para. 69.

[8] *Ibid.*, para. 78.

unprecedentedly high demand for sales financing, on the other. In order to handle the resulting volume, IAC turned its attention to the sale of short-term notes through investment dealers for the first time.[9]

Similar circumstances arose during 1955 and 1956. Then, no controls were imposed on commodity instalment credit (this aspect of the 1951 policies has not in fact been repeated since), but bank credit was again restricted. The Company responded, as before, to the pull of high demand by turning to non-bank lenders, evidently quite successfully. In the process, however, its profit rates contracted, as Table V-18 shows.

During 1958 and 1959, "when the Canadian economy was in a mild cyclical upswing not at all characterized by the excesses of earlier periods,"[10] the Company once again found itself facing restricted bank credit. Not only were its current bank credit lines cut as never before, but it was apparently encouraged, moreover, to revise downwards its expectations of future loans. The Company responded by expanding its note and debenture issues, as it had on essentially similar occasions in the past. But it also did something that it had not previously seen fit to do on a corresponding scale. It laid out large amounts, of the order of $50 millions, for a stock of marketable securities, primarily Government of Canada Bonds and trust company

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[9] Ibid., para. 85.

[10] Ibid., para. 87.

TABLE V-18

INDUSTRIAL ACCEPTANCE CORPORATION LIMITED

PROFIT RATIOS-TOTAL SHAREHOLDERS' EQUITY, 1950-1961

	Gross Income (000$)	Net Earnings* (000$)	Total Shareholders' Equity (000$)	Ratio of Gross Income	Net Earnings to: Total Shareholders' Equity
1950	16,877	2,836	14,672	16.8	19.3
1951	22,065	3,004	16,174	13.6	18.6
1952	30,261	4,997	26,957	16.5	18.5
1953	42,369	6,969	37,594	16.4	18.5
1954	39,489	6,837	40,957	17.3	16.7
1955	40,092	7,395	51,825	18.4	14.3
1956	51,714	8,586	65,053	16.6	13.2
1957	58,464	9,184	68,942	15.7	13.3
1958	60,471	10,735	74,819	17.8	14.3
1959	68,487	10,897	80,965	15.9	13.5
1960	80,810	12,089	88,313	15.0	13.7
1961	84,352	12,536	96,241	14.9	13.0
			Average 1950-1961	16.1	14.5

* Before all dividends, profit on redemption of securities, cost of debenture issues, etc.

Source: Industrial Acceptance Corporation Limited.

certificates. The end sought is simply stated: "If a sudden shortage of funds should occur, these securities could then be liquidated to provide the necessary funds."[11]

Developments within Traders Finance Corporation Limited

The overall performance of the second-largest independent Canadian sales finance company is less impressive than that of IAC, although it has always managed to maintain a quite sound basic financial condition. It, like IAC, was established in the 1920's, and the next two decades saw it open branches throughout Canada: by 1962 these numbered around ninety. Its primary raison d'être during most of its first three decades was to provide sales financing for the Ford Motor Company and capital loans to Ford dealers.

The Company also acquired a number of subsidiaries during this period, of which the largest is Trans Canada Credit Corporation Ltd., another of the largest consumer loan companies in Canada. It also acquired a controlling interest in two general insurance companies: Canadian General Insurance Company and Toronto General Insurance Company. A third insurance company, Traders General Insurance Company, was established in 1951, mainly to "insure certain risks of the parent company."[12] In a rather unusual step, for a sales finance company, it

[11] *Ibid.*, para. 89.

[12] This is a standard statement appearing in the Company's prospecti since the early 1950's.

acquired, in 1961, Frankel Steel Construction Ltd., a fairly large fabricator and erector of structural steel. It also acquired during that same year a substantial interest in Guaranty Trust Company, one of Canada's largest nonbank financial intermediaries.

Traders Finance did not make a separate submission to the Porter Commission, and its management was generally reluctant, throughout the 1950's,[13] to reveal its financial experience and condition in any substantial detail. It has been possible, however, to form a general, essentially qualitative, picture of its affairs during the years with which this study is concerned.[14] Table V-19 gives the Company's condensed balance sheets as at December 31 for each of the years 1951 to 1961, and Table V-20 gives its condensed statements of profit and loss for those years.

Like IAC, Traders Finance went into the short-term money market in 1952 as the result of restrictions in its bank credit, and, as Table V-19 shows, it has made continuous and extensive use of this source of funds ever since. The scale of its lending operations rose throughout, but the rate of growth was substantially below that of the other large sales finance companies. The basic reasons for this relatively slow progress seem to have been a highly conservative

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[13] This reticence disappeared, as it did throughout most of the sales finance industry, after the failure of Atlantic Acceptance Corporation in 1965.

[14] Senior members of the Company's current administration and a member of the staff of its underwriters kindly granted interviews to the writer and provided helpful information.

TABLE V-19

TRADERS FINANCE CORPORATION LIMITED

CONSOLIDATED BALANCE SHEETS AS AT DECEMBER 31
000$

	1951	1952	1953	1954	1955
Assets:					
Cash	13,883	12,664	14,750	15,084	14,190
Marketable Securities	6,763	7,097	9,936	11,194	12,513
Notes Receivable	92,964	141,881	183,352	161,801	210,470
Loans, Mortgages and Sundry Receivables	2,983	3,719	5,475	6,703	8,992
Fixed Assets, Net; Sundry Assets	555	664	923	1,404	1,654
Deferred Charges					
Total Assets	117,148	166,025	214,436	196,186	247,819
Liabilities and Shareholders' Equity:					
Bank Loans	9,700	30,100	40,000	12,650	32,500
Sundry Payables, etc.	6,870	11,514	14,730	15,764	17,022
Contingency Reserves, etc.	8,468	11,768	15,897	16,082	20,680
Short Term Notes Payable		8,200	28,945	N.A.	60,390
Collateral Trust Notes-Secured	64,612	68,107	65,018	95,962	60,197
Sinking Fund Debentures	12,502	13,633	23,808	22,640	19,958
Minority Interest in Equity of Subsidiaries	758	803	866	1,039	1,202
Total Liabilities	102,910	144,125	189,264	164,137	211,949

TABLE V-19 (Continued)

	1956	1957	1958	1959	1960	1961
Assets:						
Cash	18,056	28,188	19,588	22,905	16,315	15,178
Marketable Securities	16,242	16,961	17,424	17,575	21,153	23,666
Notes Receivable	274,904	274,886	239,005	276,291	287,518	284,644
Loans, Mortgages and Sundry Receivables			10,810	12,322	22,858	27,037
Fixed Assets, Net; Sundry Assets	1,439	1,372	1,426	1,474	1,453	1,461
Deferred Charges		2,235	2,031	1,789	1,860	2,001
Total Assets	310,641	323,642	290,284	332,356	351,157	353,987
Liabilities and Shareholders' Equity:						
Bank Loans	43,500	43,500	13,900	35,000	27,000	15,000
Sundry Payables, etc.	20,701	21,208	19,667	20,263	18,221	20,830
Contingency Reserves, etc.	23,691	23,927	23,595	27,756	31,375	30,851
Short Term Notes Payable	73,430	80,770	60,804	78,010	N.A.	99,610
Collateral Trust Notes-Secured	79,756	77,853	92,000	90,876	190,763	100,973
Sinking Fund Debentures	30,057	35,093	37,618	36,489	41,477	39,971
Minority Interest in Equity of Subsidiaries	1,191	1,170	1,194	993	982	1,000
Total Liabilities	272,326	283,521	248,778	289,387	309,818	308,235

TABLE V-19 (Continued)

000$	1951	1952	1953	1954	1955	1956
Preferred Stock - 4½%	3,014	3,014	3,009	3,009	3,031	3,027
- 5 %				5,000	4,994	4,948
Common Stock - A	2,426	7,799	10,264	11,290	13,625	13,965
- B	480	480	480	480	480	480
Earned Surplus	8,318	10,607	11,419	12,270	13,740	15,895
Total Liabilities and Shareholders' Equity	117,148	166,025	214,436	196,186	247,819	310,641

000$	1957	1958	1959	1960	1961
Preferred Stock - 4½%	3,024	3,017	3,002	2,999	2,993
- 5 %	4,907	4,822	4,468	4,464	1,166
Common Stock - A	14,176	14,324	14,804	14,808	20,928
- B	480	480	480	480	480
Earned Surplus	17,534	18,863	20,215	18,588	20,185
Total Liabilities and Shareholders' Equity	323,642	290,284	332,356	351,157	353,987

Source: Traders Finance Corporation Limited.

TABLE V-20

TRADERS FINANCE CORPORATION LIMITED

CONSOLIDATED STATEMENTS OF PROFIT AND LOSS FOR YEAR ENDED DECEMBER 31, 000$

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
Income from Operations	11,405	16,038	20,355	21,277	22,306	28,924	29,732	29,179	31,968	33,775	34,954
Other Income	445	381	509	744	882	953	1,085	759	814	815	1,575
	11,850	16,419	20,864	22,021	23,188	29,877	30,817	29,938	32,782	34,590	36,529
Interest on Loans and Funded Debt	3,194	3,405	5,554	6,042	5,132	8,419	10,692	9,457	10,413	12,422	11,801
Other Operation Expenses	4,156	4,984	6,626	7,950	9,077	11,371	12,103	11,745	12,883	13,827	14,068
	7,350	8,389	12,180	13,992	14,209	19,790	22,795	21,202	23,296	26,249	25,869
Profits before Income Taxes	4,500	8,030	8,684	8,029	8,979	10,087	8,022	8,736	9,487	8,341	10,660
Provisions for Income Taxes	2,215	4,136	4,072	3,427	3,805	4,619	3,669	3,939	4,604	4,054	5,060
	2,285	3,894	4,612	4,602	5,174	5,468	4,353	4,797	4,883	4,287	5,600
Provision for Minority Interest	80	69	146	200	188	73	14	45	102	98	127
Net Profit for Year	2,205	3,825	4,466	4,402	4,986	5,395	4,339	4,752	4,781	4,189	5,472

Source: Traders Finance Corporation Limited.

management and excessive dependence on the relationship with Ford. A large number of the Company's Ford dealers transferred their allegiance during the latter part of the 'fifties when the Ford Motor Company established its own automobile-finance subsidiary. (There is also reason to believe that Trans Canada Credit was less successful than some of its competitors in expanding its volumes of cash loans to private borrowers.) The Company's annual reports for 1960 and 1961 refer to a series of sweeping reorganizations of personnel and operating methods during the preceding two or three years, thus suggesting another basic difficulty that may have hampered it.

As Table V-19 shows, the Company divided its borrowings almost equally between long and short-term notes. But if its issues of debentures are included with its long-term indebtedness, a broad tendency to rely increasingly on long-term debt becomes apparent. This is due to the same type of restrictions in its borrowing options that produced similar tendencies in IAC and the other large industry users of the money market. Another notable feature of the Company's comparative balance sheets is the large successive increases in its issues of common stock. It also carried substantial amounts of marketable securities.

The rather indifferent performance of its subsidiaries did much to prevent the Company's earning performance from matching those of its competitors in the sales finance industry. A number of its Annual Reports refer to or imply underwriting losses incurred or unusually lower profits earned by them.[15] They also refer to various other deductions from accumulated surplus, such as extraordinary write-offs of uncollectable accounts receivable and "losses arising from the conversion of wholesale in dealers' hands, fraudulant retail, and deficiencies on sales of repossessions."[16] We do not get the impression that the restrictions, in 1951, 1956 and 1959, of bank credit produced major difficulties in themselves. The Company was clearly able to operate in the money market on a large scale, although no doubt at the cost of increased interest charges, as Table V-20 indicates. The expansion, in the late 'fifties, of bank lendings for the purpose of acquiring automobiles and consumer durables seems, however, to have had a more substantial adverse effect on the Company's fortunes. This development is described in its Annual Report for 1961 as "the most important problem for our industry."[17]

A Note on General Motors Acceptance Corporation of Canada Limited

The very name of this company explains clearly why, in spite of its being the third largest sales finance company in Canada, it cannot

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[15] The Company's Annual Reports for 1957 and 1958 are most explicit on this score.

[16] Annual Report for 1960.

[17] This theme crops up repeatedly in the empirical data relevant to this study and it was reiterated by most of the industry personnel whom the writer interviewed.

be looked upon in the same light as the rest of the industry, as far as sensitivity to prevailing monetary conditions are concerned, at any rate. It is therefore not necessary to discuss it in the detailed fashion that was appropriate to IAC and Traders Finance.[18] GMAC's function, of course, is to provide financing facilities for the acquisition of General Motors vehicles, in competition with the other sales finance companies. It does not operate, as do the other large sales finance companies, in the rest of the consumer credit field. It does, however, generate the bulk of its loanable funds in ways that are analogous to theirs' in some respects, though not in others. The Company's reliance on bank credit is minor: its bank indebtedness is usually no more than around 10% of its total liabilities. It makes up for this by its very extensive borrowings in the short-term money market. It also operates in the long-term market on a substantial scale.

This kind of financial structure does not make GMAC impervious to the prevailing monetary climate--obviously its profit rates will be sensitive to market rates of interest. The Company's uniqueness derives from the fact that, given the corporate family that it possesses, there is little that the monetary authorities could do (short of certain

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[18]The Company certainly regards itself as being fundamentally different from the rest of the sales finance industry. It has for this reason declined to join the Federated Council of Sales Finance Companies (although it did provide its share of the data compiled by the Council for submission to the Porter Commission) and has generally avoided identification with the sales finance industry as a whole.

specific measures that will be discussed below), that would effectively constrain its lending capabilities. This lending capability is, realistically, a function almost entirely of the demand for General Motors vehicles, and it is that basic feature that sets GMAC apart from independent sales finance companies.[19]

A Note on the Institutional Character of the Nonbank Lenders to the Sales Finance Industry; 1953-1962

In the early 1950's, before a real money market existed in Canada, a company (e.g., IAC), wishing to obtain short-term credit outside of the banking system was confined to a relatively small number of prospective institutional lenders such as insurance companies who, as the Porter Commission noted, possessed a quite sophisticated understanding of monetary mechanics. These lenders were not only susceptible to the attractions of even fractionally higher interest rates but, because of imperfections in the market, were also in a position to insist on changes in the financial structures of their debtors that would militate against illiquidity, as far as their own claims were concerned. Hence the abovementioned equity and leverage requirements that sales finance companies have been compelled to meet. The advent of a Canadian money market in the mid-'fifties broadened the range of

[19] The foregoing is based on an examination of GMAC's financial statements. It is also based on interviews with senior officers of the Company, with other members of the sales finance industry, and with individuals within the financial community in general.

prospective sources that the industry could tap, but not fundamentally. The main nonbank lenders continued to be the same sort of institutions as before, and essentially similar terms and conditions prevailed. These were especially applicable to long-term notes and debentures, types of securities that became increasingly necessary owing to the unreliability of the banks on the one hand and market imperfections on the other. The growing tendencies on the part of the large companies to carry stocks of relatively unprofitable but highly liquid marketable securities attest further to their concern about the rigidities in their nonbank supply situation. The trend towards diversification of activities that developed during this decade does not, however, seem to have been basically inspired by considerations of supply of funds. On the contrary, as Table V-4 shows, the acquisition of subsidiaries has meant a quite substantial allocation of funds away from the basic business of sales financing. There is reason to believe that this trend was prompted mainly by a desire to move into fields less vulnerable to monetary and competitive constrictions.

For all its rigidities, however, it was the increasing availability of nonbank sources of funds that enabled the sales finance industry to escape as effectively as it did the restraints that the chartered banks sought to impose on them. It is thus one of the several ironies of Canadian monetary experience during the 'fifties that, in promoting a more efficient and pervasive money market in this country, the Bank of Canada made it easier for an outstanding target of its contractionary efforts to evade them. This, again, does not mean that the industry would otherwise have been unable to expand in the face of restrictive monetary conditions. As we have seen, the larger companies, who have been the main industry users of nonbank credit, were able to draw on the loanable funds of other financial institutions, even before the advent of the more sophisticated money market facilities that developed after 1954. They might have been able to bypass these institutions somewhat more easily thereafter because of these developments, especially in the important area of short-term note issues, as Table V-21 suggests. They may also have achieved thereby greater flexibility along with somewhat lower borrowing costs. But their ability to expand their lendings would probably not have been significantly less if the pre-1954 conditions had continued.

Summary and Conclusions of Chapter V

It can be said, on the basis of the foregoing, that the primary determinant of the evolution of the members of the Canadian sales finance industry, during this decade of dynamic growth, was their desire to meet the expanding demand for their facilities in the face of a central bank intent on contractionary monetary policies. This required the development of sources of loanable funds outside of the banking system. We have seen how the industry, and especially its largest members, successfully met this challenge.

TABLE V-21

SHORT TERM NOTE PLACEMENTS BY THE TEN LARGEST SALES FINANCE COMPANIES, 1953-1961
(millions of dollars)

Year End	Total Short Term Notes Placed During Year	Direct Placements	Market Placements	Year End Total Outstanding
1953	593	*	*	198
1954	460	*	*	151
1955	384	85	299	228
1956	803	126	677	314
1957	1,573	159	1,414	387
1958	796	112	684	279
1959	1,431	110	1,321	392
1960	1,892	504	1,388	413
1961	1,450	324	1,126	323

* Not available.

Source: Federated Council of Sales Finance Companies.

They did not, however, achieve these goals without consequences to themselves. They were obliged to incur increasing amounts of long-term liabilities. Their profit rates also narrowed, partly because they were unable to entirely pass on to their customers the high interest rates they were forced to pay their lenders, and partly because market rigidities compelled them to carry substantial stocks of low-yield marketable securities. More than this, however, they experienced an erosion of their competitive position within the sales finance field. As we saw earlier, the banks, with, apparently, the tacit approval of the Bank of Canada, substantially encroached upon the industry's traditional pre-eminence there. This adverse development stimulated some of its larger members to intensify their already energetic efforts towards diversification.

CHAPTER VI

AN EVALUATION OF THE BANK OF CANADA'S POLICIES VIS-A-VIS THE SALES FINANCE INDUSTRY; 1953-1962

The Case in Favour of Selective Regulation of Commodity Instalment Credit

The case in favour of selective regulation[1] of commodity instalment credit is composed of two categories of arguments. The first concerns the behaviour of sales finance companies as members of the set of nonbank financial intermediaries. Given the contemporary structure of the Canadian sales finance industry, it refers primarily to IAC and Traders Finance. GMAC is also partly affected. So, to a much lesser degree, is most of the remainder of the group of "ten largest companies", but the dozens of smaller firms who depend almost entirely on bank credit for lending capacity are not. Nor, of course, are the other purveyors of commodity instalment credit, of whom department stores are the most important.

As we saw above, the nonbank borrowing and the lending activities of sales finance companies may be described in terms of their negative impact on the demand for money. They may also be described, in a manner that was suggested to be especially meaningful to sales finance companies,

[1]These controls should not be confused with those concerned with such matters as disclosure of interest charges, repossession in the event of debtor delinquency, and the like. The arguments for and against these controls involve considerations that are largely outside the scope of this study.

in terms of the activation of inactive bank balances: i.e., in terms of the velocity of money. No matter what terminological technique one chooses the upshot, however, is much the same. Existing inflationary pressures are augmented, and the central bank may be forced to bear down harder on the banks than would otherwise be necessary. This, allegedly, is not only inequitable to the banks, but is also conducive to less successful monetary policies than an institutional focal point broader than the banking system would permit.

The second, and more comprehensive, category of arguments in favour of regulating commodity instalment credit concerns all lenders, irrespective of the sources of their funds. It derives from the endemically procyclical character of the demand for commodity instalment credit, which, in turn, is rooted in the procyclical demand for consumer durables and automobiles. In consequence, and also because it is modified by a peculiar repayment mechanism, this type of credit is regarded as a force that tends to delay and respectively deepen and elevate the troughs and peaks in the level of general economic activity. It is also believed to produce additional deleterious effects. Perhaps the most important of these, as far as economic stability is concerned, is that it nourishes the volatility of the output of certain strategic areas of the economy, the consumer durables sector in general and the automobile industry in particular. It is also looked upon as a misallocator of resources during boom times, which enables these areas to expand at the expense of others.

Two factors combine to endow the above attributes of commodity instalment credit with a particularly disquieting quality. These are its tremendous growth in recent decades,[2] and its comparative immunity to conventional monetary policy. Its demand is allegedly highly interest-inelastic, and it is precisely because conventional monetary policy impinges on the in this instance impotent variable of the rate of interest that it is ineffectual in curbing commodity instalment credit when curbing is called for by the state of the economy.

This, then, constitutes the quintessential case in favour of selective regulation of commodity instalment credit. The analysis presented in the foregoing chapters has on the whole affirmed its validity with respect to the behaviour, between 1953 and 1962, of the largest

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[2]There also exists in the literature something that may be called "the burden theory of business fluctuations". It suggests, in effect, that there is a certain limit to the amount of debt that consumers feel able to carry, and that when they reach this limit they will react by retrenching drastically, thereby plunging the economy into a downswing. The underlying premise is that total outstandings have a tendency to increase indefinitely at a faster rate than the level of income. (See Clay J. Anderson, "Consumer Instalment and Home-Mortgage Debt," Journal of Business, XXXIX, July, 1956, p. 201, for a more complete statement of this argument.) Others have argued, however, that even if this premise were true the implication suggested does not necessarily follow. This view derives from a life-cycle model of debt generation whereby individuals become debtors on a certain specified occasion, when they marry, and then repay steadily for a certain interval thereafter. The model ultimately implies that the ratio between total debt and income will eventually level-off, even though the absolute rate of increase in total debt is rising. (See Alain Enthoven, "The Growth of Instalment Credit and The Future of Prosperity," American Economic Review, XLVII, December, 1957, pp. 913-29.) American experience since World War II appears to be consistent with this model, according to Warren L. Smith, "The Effects of Monetary Policy on the Major Sectors of the Economy," in Ritter (ed.), op. cit., p. 189.

Canadian supplier of this type of credit, the sales finance industry.[3] As we know, the Bank of Canada responded to the problem by requesting or tacitly permitting the chartered banks to sharply restrict their loans to the industry on two occasions during this decade. Before discussing the appropriateness of this response, it is necessary to consider other measures that have been adopted on various occasions to attain analogous ends.

On the Effectiveness of Selective Regulation of Commodity Instalment Credit

The countries in addition to Canada whose experience is most relevant to our purposes are the United States and Great Britain, particularly the United States.[4] The American government imposed minima on down payments and maxima on maturity terms of commodity instalment

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[3] Similar conclusions have been reached by others with respect to British and American experience during analogous periods. For British experience see F.R. Oliver, The Control of Hire-Purchase, London, George Allen and Unwin, 1961. American experience is analyzed in Conference on Regulation and Views on Regulation, Consumer Instalment Credit Series, Part II, Vols. I and II, and Part III, Washington, National Bureau of Economic Research and Board of Governors of the Federal Reserve System, 1957 (cited hereafter as Consumer Instalment Credit Series); and Robert P. Shay, Regulation W: Experiment in Credit Control, University of Maine Studies, Second Series, No. 67, Orono, University of Maine Press, 1953. McCracken, Mao, and Fricke, op. cit., however, adopt a dissenting position, on the grounds that the problems caused by commodity instalment credit have not been quantitatively excessive.

[4] The countries that have resorted to controls at one time or another during the post-World War II era are Canada, the U.S.A., Great Britain, France, the Netherlands, Denmark, Austria, New Zealand and the Union of South Africa.

credit during World War II, in 1948 and 1949, and during the Korean War. The usual procedure was for the Administration to decree, after having received authority to do so from both houses of Congress, the respective minima and maxima on the basis of existing market conditions. (Minor modifications were made on a few subsequent occasions, reflecting marginal changes in conditions.) Britain's experience that is most pertinent concerns the years 1956 to 1958. There the regulatory devices were much more comprehensive than any yet attempted in North America. They restricted, in addition to down payments and repayment intervals, equity and long-term debt issues of sales finance companies, and they also involved the imposition of special taxes on durable goods. There, too, it was the legislative arm rather than the executive or the central bank that made the ultimate decisions to take restrictive action. In Canada, the government, at the request of the Bank of Canada, imposed minima for down payments and maxima for repayment intervals on two occasions: during World War II and the Korean War.

The effects of the above devices on the economies concerned can be classified optionally either as part of the case for or the case against them. This is due to the fact that they have been, and indeed must always be, both positive and negative. The purpose of the restrictions is to cause prospective borrowers to either desist from borrowing altogether, at least until some future date, or to reduce the amounts that they currently do borrow. There can be no doubt that they must achieve this purpose to a certain degree.[5] After all, they significantly augment the disutilities associated with this type of borrowing (although the degree to which they do so is necessarily indeterminate since it requires knowledge of the level of borrowing that would otherwise have prevailed). It therefore seems realistic to assume that regulation succeeded, on the occasions mentioned above, in rendering the level of new commodity instalment credit extensions and also, therefore, the concurrent level of total outstandings, substantially lower than they would otherwise have been. Corresponding, though probably somewhat weaker, effects on the levels of output of the industries that produce the durable goods involved can also be assumed. This implies further that the destabilizing potentialities of these industries were circumscribed accordingly.

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[5]In view of the fact that no country has ever restricted only one of these variables there is no practical way of isolating empirically the respective consequences of each of these aspects of regulation. It is intuitively plausible that, in all likelihood, imposed minimum down payments are a less effective device than imposed maximum repayment intervals. This is so because automobiles constitute the largest category of goods concerned. Since the trade-in allowance frequently represents a major portion of the sale price of the new vehicle, the regulatory increase in down payment would have to be a very large one to have a meaningful impact in a substantial proportion of transactions. This is much less true, however, of transactions involving the other consumer durables, where trade-ins are relatively rare and generally involve only minor portions of the sale price of the new good. The restrictions on the repayment intervals, on the other hand, are probably a more effective deterrent because they would compel the borrower to divert from other uses larger portions of his post-loan income flow than he would otherwise do, although it also reduces his interest costs.

But there are a number of reasons why we cannot be similarly sanguine about other aspects of the effects of regulation, either on the above occasions or in general. Regulation is imposed in circumstances of rising incomes and, probably, of rising expectations with respect to future incomes. The prospective borrowers whom the regulations inhibited therefore turn to the satisfaction of other wants according to a certain hierarchy, in the pursuit of which the regulations place no obstruction. It seems highly unlikely, given the circumstances, that the want of increased savings ranks highly within that hierarchy. Undoubtedly, people veer towards increased consumption of other goods and towards other sources of credit. "Thus the result of changing the terms of commodity instalment credit is likely to be a heavily directional effect, rather than an influence on the level of national income generally."[6] And there is little reason to suppose that the industries that benefit from this directional effect are entirely devoid of destabilizing capabilities of their own. Moreover, these regulatory devices are aimed at the level of demand for consumer durables, especially automobiles. They therefore dampen the demand for the specific type of credit that caters to this sector. Sales finance companies and the various retailers who provide commodity instalment credit are hit. However, since the latter, especially department stores, also sell other goods on credit, and since the level of demand for these other goods rises, it is the sales finance companies who are the main victims. The banks benefit immensely

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[6] McCracken, Mao, and Fricke, op. cit., p. 155.

and so do the consumer loan companies, including, of course, those affiliated with sales finance companies. Apart from the by no means irrelevant considerations of institutional equity that thus arise, all this is really the other side of the coin as far as the offsetting effects discussed in preceding sections are concerned. Now the use of devices designed to weaken inflationary pressures in the consumer durables sector leads to the strengthening of inflationary pressures elsewhere.

The foregoing is not intended to suggest that the use of these devices on the occasions specified was necessarily unwarranted or unsuccessful. These were occasions when war was being waged, had just been waged, or seemed imminent. The regulations thus constituted only one aspect of a large set of controls and policies designed to orient the economy along lines dictated by existing and anticipated military and political considerations. Their effectiveness, like that of analogous restrictions, depended ultimately on the willingness of the general public to subordinate their individual preferences to the national interest. It is probable that this willingness did in fact exist in large measure on these occasions, but it is at least a plausible hypothesis that it would not have been forthcoming to nearly the same degree in the absence of a national emergency. And, given widespread popular antipathy to restraints of this kind under normal conditions, it is to be expected that the directional reactions mentioned above would occur *a fortiori*. Nor would these likely be the only reactions to peacetime regulation. A variety of purely evasive ones could also be envisaged. Objections to regulation on equity grounds also arise. In particular, cash purchasers of consumer durables would be spared sacrifices at the expense of credit purchasers. The same would also be true of individuals with access to other forms of credit, secured either by their present assets or by their relatively high and determinate anticipated future earnings, in contrast with, say, those members of the working class whose income levels are highly vulnerable to the business cycle.[7] Another set of possible difficulties derives from the upsurge in commodity instalment lending that could be expected to follow the lifting or relaxing of the regulatory controls. These upsurges have, on the occasion mentioned above, been of very considerable force in Canada.[8] And, rather ironically, they probably occurred as belated concomittants rather than substitutes for the directional reactions that developed while the regulations were in effect. In other words, it is probable that, given the optimistic expectations held by the general public, many people attempted to satisfy other wants during the periods of restriction and then, later, borrowed to acquire the consumer durables that they had desired all along. While it is true that post-regulation upsurges may well nourish the destabilizing potentialities inherent in the automobile and other consumer durables industries, it does not, however, necessarily follow that they are always undesirable events. They usually develop during the early stages of a general

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[7]For a more complete discussion of these considerations, see Harry G. Johnson, The Canadian Quandary, Toronto, McGraw-Hill, 1963, pp. 220 ff.

[8]See Chart IV-4.

downswing and therefore contribute to its amelioration. We observed above how this occurred here in 1952 and 1953, and Canada's experience probably corresponded to that of other countries in analogous circumstances. Problems arise subsequently, when the upsurge continues into the upswing. Here, too, Canadian experience is relevant, as is that of the British. As one authoritative British commentator observed in 1959, about a year after the expiration of the regulations:

> "The proper conclusion to be drawn from these last two weeks of sudden [commodity instalment lending] spree may not be that there should be great apprehension for the short term, but that there needs to be a reconsideration for the long term.... The system of varying these controls as a weapon to regulate the economy has shown itself to be a system of creating widely fluctuating cycles in one relatively small sector of industry.... They have not been a good anti-inflationary regulator to use, and there should be a strong prejudice against re-imposing them again."[9]

The Radcliffe Committee explored the whole matter thoroughly (it will be recalled that the controls Britain imposed during the mid-'fifties went far beyond those ever attempted in either Canada or the U.S.A., even in wartime), and came to the following conclusion:

> "These controls have the advantage of securing a sizeable and rapid impact on total demand; but this is a once-for-all effect, which tends quickly to disappear. They are open to easy avoidance (as distinct from evasion) which grows rapidly if the controls are maintained for any appreciable time, and we could not recommend any attempt at a general control of trade credit which would seem to be the only logical way of stopping such avoidance. Above all, these controls have severe directional effects

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[9] The Economist, (London), November 8, 1959, p. 480.

> which are potentially harmful to economic progress. It may sometimes be desirable to secure just these directional effects: if at a time of excessive demand the industries most affected by these controls happened to be among those with the longest order books and most inflated activity, there would be a clear balance of advantage in imposing [commodity instalment credit] controls while other, slower-working, restraints were brought into play. There may thus be times when the authorities will be justified in using [commodity instalment credit] controls for a quick effect while the influence of other measures is working through; but, apart from special cases of this kind, they should be reluctant to use these controls for operating on the general economic situation."[10]

It is now appropriate to refer briefly to a few other possible regulatory devices. The first two of these are loan ceilings and minimum collateral requirements on short-term borrowings by lenders. They have been mooted in the literature for some years,[11] but, as far as can be ascertained, there is no precedent for their having been imposed by decree. Loan ceilings would fix the total outstandings of each sales finance company or analogous lender at a maximum derived from its total outstandings as at the date the regulation came into effect, or from some sort of average total for a certain base period. They have the advantage of being easily enforced: unlike the regulation of lending terms, discussed above, it would not be necessary to police huge numbers of transactions. But they are also subject to some serious drawbacks.

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[10] Report of the Committee on the Working of the Monetary System, London, Her Majesty's Stationery Office, 1959, p. 183. (Emphasis added.)

[11] See, for example, J.S. Earley, "Further Comment," Consumer Instalment Credit Series, Part II, Volume II, p. 154. Also, McCracken, Mao, and Fricke, op. cit., p. 163.

The most objectionable of these is that they would discriminate among individual lenders. Smaller lenders, or those who for one reason or another were entitled to only a relatively small quota would find themselves at a severe disadvantage in relation to their larger competitors. There would also exist a strong incentive for devising the sort of black market arrangements that were fairly prevelant in this country during the last war when analogous maxima were imposed on a variety of industries.

Although the device of minimum collateral requirements on short-term borrowings also lacks official precedent it has, as we saw earlier, an ample basis in the actual institutional practices that have developed in Canada and, no doubt, in other countries as well. Details can be found in the prospecti of virtually all Canadian sales finance companies, in the form of quotes from trust indenture requirements of accounts receivable that must be pledged in support of the short-term issues in question. Since, however, it is usually the very purpose of these issues to generate further accounts receivable subject to an approximate one-for-one correspondence, it may be doubted that this device constitutes a meaningful constraint on the lending capacity of the borrower, although it is certainly useful as a means of ensuring his solvency. One potential effect, and this can be discerned from the empirical data reviewed above, is to push sales finance companies further into the long-term debt and equity markets than they might otherwise have gone. Another possible consequence, although the empirical data considered above are ambiguous as to its actual occurrence, is that affected companies might turn to their subsidiaries or affiliates for loanable funds. This escape hatch would, as we know, be available on a meaningful scale in Canada only to the larger firms. It would thus endow them with yet another competitive advantage over their smaller rivals. Also, this restriction would have practically no effect on retailers whose operations include selling consumer durables on the instalment plan.

Essentially similar discriminatory considerations arise with respect to another regulatory device; the imposition of restrictions on the long-term debt and equity funds that sales finance companies may obtain. As was noted above, this device was resorted to in Britain during the mid-'fifties, in conjunction with the familiar conventional controls, and the indications are that it helped make the overall controls fairly effective in restraining her sales finance industry.[12]

A variable excise tax on consumer durables, however financed, avoids the discriminatory effects that we have been discussing, and is also much easier to administer.[13] It would not, however, be without vexations of its own. Problems would arise as to the differential rates

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[12]Curiously, the British authorities neglected to provide for the fact that British sales finance companies, unlike their counterparts elsewhere, accept substantial amounts of unsecured deposits from the general public. It has been suggested (by McCracken, Mao, and Fricke, op. cit., p. 162) that this loophole enabled the British industry to circumvent the government's intent to an appreciable degree.

[13]Milton Friedman has argued plausibly that the regulation of down payments and repayment intervals also constitutes a tax in its effects, but an objectional one, for most of the reasons discussed above. See his "Consumer Credit Control as an Instrument of Stabilization Policy," in Consumer Instalment Credit Series, Part II, Volume II, pp. 86-95.

appropriate to the various goods taxed. Given the highly imperfect markets for consumer durables, there would probably be significantly different tax-shifting mechanisms to reckon with. It might also arouse expectations of further tax changes that could have awkward consequences in the future. And, it is not inconceivable that once the government became accustomed to the substantial revenues that such a tax would undoubtedly generate, it might be loath to forego them when conditions changed.[14]

The Appropriateness of the Bank of Canada's Behaviour towards the Sales Finance Industry between 1953 and 1962; the Consequences to the Industry; the Need for a Flexible Mix of Monetary and Fiscal Policies

The foregoing discussion of what might be termed the conventional methods of controlling commodity instalment credit enables us to better appreciate the dilemma that confronted the Bank of Canada during the mid-'fifties. Here was the economy being subjected to strong inflationary and, in its view, misallocative, forces, with the sales finance industry acting as a very energetic agent of some of them, but in circumstances that made it doubtful that conventional controls would be effective. The sense of national emergency that had been inspired by the Korean War had largely abated. Prevailing boom conditions were nowhere more pronounced

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[14]Canadian experience attests to the reality of this prospect. Special excise taxes were imposed during the Korean War on automobiles, phonographs and television sets. These were maintained, though at reduced rates, after the emergency had ended, through all of the cyclical phases that the Canadian economy experienced until 1961. Then the tax on automobiles was repealed, but those on phonographs and television sets are still in effect.

than in the automobile industry, where an aesthetic revolution had combined with rising incomes to elevate demand to unprecedented levels. It was therefore reasonable that the Bank of Canada should eschew the regulation of down payments and repayment intervals, and attempt instead to persuade the sales finance industry to exercise self-restraint. The attempt failed, as we know.

So the Bank turned to the chartered banks, with whom its relationship over the preceding two decades constituted something of a monument to moral suasion, and suggested that they curtail their loans to the sales finance industry. The banks acceded, but the consequences brought little satisfaction to the Bank. The larger sales finance companies, who overwhelmingly dominated the industry, proceeded to replace the lost loanable funds by recourse to both the long and short-term money markets, and drew on U.S. sources as well. (It is also quite conceivable that they succeeded in expanding their lending operations beyond what they would otherwise have attained, by filling gaps resulting from contractions by smaller companies less able than they to borrow outside of the banking system.) Hence the Governor's sharp attack on them in his Annual Report for 1956.

Anyone not privy to the deliberations of the senior management of the Bank of Canada during the late-'fifties is necessarily at a disadvantage in a discussion of its policy of those years <u>vis-à-vis</u> the sales finance industry. There is a good deal less objective evidence concerning both its motivations and its overt actions during this period than there is for the earlier one. The Bank made no declaration analogous to that of 1957.

Nor did Mr. Coyne refer explicitely to the industry in any of his increasingly frequent and outspoken public pronouncements. Nevertheless, it is clear that the later events must be considered with the earlier ones in mind.

For the Bank, a memorable feature of its 1955-1956 encounter with the sales finance industry must have been the latter's ability to fend off, to a degree that far surpassed that of other financial intermediaries, the restraints of both general monetary policy and the specific measures directed against it. It is not unreasonable, therefore, to attribute to the Bank's management a certain receptiveness to the transfer of a sizeable procyclical and potentially destabilizing phenomenon, commodity instalment credit, from a singularly recalcitrant institution to a traditionally far more malleable one. It is worth recalling, in this connection, that the chartered banks had not moved appreciably into this lending area during the mid-'fifties, even though the just-amended Bank Act had endowed them with the power to do so and in spite of the relatively profitable prospects therein. Add the fact, documented earlier,[15] that the Bank regarded this transfer as the rectification of an existing institutional inequity, and the impression emerges that the Bank was perhaps more disposed, in 1959, to countenance the partial displacement of an obdurate industry than it was concerned with reducing the total supply of commodity instalment credit. There probably existed, in its view, a less urgent need than before to achieve the latter end,

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[15]See Chapter II.

in any case. Demand for automobiles and consumer durables generally was high, to be sure, but there was no upsurge comparable to that of the mid-'fifties. On the other hand, the horizon, as scanned by the Bank, was marked by a variety of inflationary portents, of which the high demand for these goods was but one. It was, in a word, the aggregate of all manifestations of "excessive" spending that was increasingly arousing its anxiety and engaging its energy.[16]

Seen in this light, the failure of the Bank to repeat its appeal to the sales finance industry for self-restraint is more comprehensible. It could now reasonably anticipate that market forces would achieve what diplomacy, which had already failed once, might not. The banks had cut the industry's credit while moving into the same lending field themselves. This last development promised to be an especially effective restraint on the industry. In 1955-1956, when the industry's bank credit had been cut, no other lender of commodity instalment credit had filled the breach. Now there would be less breach to fill. There existed, in effect, reason to believe that, although the industry could replace lost bank credit by offering, as it had done before, appropriately high interest rates to nonbank lenders, it might choose not to do so to the same extent. As we saw above the interest rates that the industry was able to earn during this interval were displaying a distinct stickiness in an upward direction. Thus, it could be expected that demand for commodity instalment credit

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[16] It may be noted, in this connection, that in his Annual Report for 1959 the Governor of the Bank of Canada inveighs against existing levels of aggregate spending, especially on imports, but implies relative equanimity on the subject of demand for consumer durables.

was approaching a level where it was no longer so invincibly interest-inelastic.

The above analysis does not, however, constitute an endorsement of the Bank of Canada's activities during this period. Many writers have criticized both its obsessive preoccupation with the perils of inflation, at the expense of other considerations, and the specific steps it took to fight them.[17] It can be granted, on the basis of the foregoing, that the Bank did not lack reasons for concern about the phenomenon of commodity instalment credit in general and the behaviour of its leading purveyor in particular. Nevertheless, the measures taken by the Bank or the events tolerated by it cannot be regarded as ideal. There are two categories of reservations; the first relating to their effects on the phenomenon and the second to their consequences for its main institutional vehicle.

Let us consider the second category first. The writer's interviews with industry people and a reading of the evidence presented by members of the sales finance industry to the Porter Commission produced an unambiguous sense of the trauma that they experienced when subjected, in their view at the Bank's behest, to sharply restricted bank credit, on the one hand, and very substantial bank competition on the other.[18] This, together with what

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[17]See in particular, H. Scott Gordon, op. cit.

[18]For example, the following appears on pages 99-100 of the submission of the Federated Council of Sales Finance Companies to the Porter Commission:

> "While the 1956-1957 bank credit line freezes and reductions were imparted through financial institutions which were then only marginally competing with the

they regarded as a growing encroachment on the part of the Industrial Development Bank into other lending areas where they had been operating

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sales finance industry, the 1959 situation was drastically different. <u>The wide cut in bank credit lines, coming at a time when many of the chartered banks were actively expanding their operations in areas competitive with the sales finance industry, raised a problem of business impartiality towards customers who had now become competitors</u>.

"The suddenness of the cuts and their extension to large and small sales finance companies is strongly questioned by a large number of members of this Council. <u>Having regard for the economic situation in 1959, it can be said that the wrong policies were transmitted through the wrong channels in the wrong manner</u>.

"Since the meetings between the Bank of Canada and representatives of the sales finance industry in late 1956, there have been no contacts between monetary authorities and the sales finance industry."

(Emphasis added.)

Elaborating on this in response to questions from Commissioner Gibson, Mr. R.M. Willmott, President, Traders Finance, explained firstly that by "wrong policies" the Council was referring to the fact that the restrictions of bank credit came after the industry's new-loans-extended indicator had peaked. Then the following exchange occurred:

<u>Commissioner Gibson</u>: "You do imply here in effect that this was the policy of the central bank. Is this so?"

<u>Mr. Willmott</u>: "That was our understanding, yes."

<u>Commissioner Gibson</u>: "The banks put this into effect, the chartered banks, is that not right?"

<u>Mr. Willmott</u>: "We understood that it was the result of a directive from the Bank of Canada or after discussion with the Bank of Canada that the chartered banks put this into effect <u>at a time when the chartered banks were becoming more and more competitive with us in our own field</u>."

(Page 5466, Hearings at Ottawa, Sept. 24, 1962. Emphasis added.)

on an increasing scale,[19] confirmed earlier fears that they had become something of a pariah in the eyes of the monetary authorities. So they began to look afield, and further intensified their efforts towards diversification, as illustrated by the behaviour, discussed above, of IAC and Traders Finance.

That this diversification of outlays (and the concomitant diversification of borrowings), was not an altogether wholesome development did not become apparent until 1965, when the collapse of Atlantic Acceptance Corp. plunged the industry into a crisis from which it has not yet fully recovered. In its wake the liquidity of many sales finance companies was impaired. Some, like Laurentide Financial Corp., Alliance Credit and Labrador Acceptance, were actually driven into receivership or reorganization, with reverberations that are still felt throughout Canada's entire financial system.

It is, of course, too much to suggest that the Bank of Canada bears any direct responsibility in these episodes.[20] That responsibility must be laid at the doorsteps of the managements of the firms involved and, to a lesser degree, at those of their counterparts throughout the industry. But the Bank is not without a measure of indirect responsibility. Its behaviour towards the industry during the latter part of the 'fifties

[19] See FCSFC, pp. 57-63, for a rather spirited criticism of the inroads made by the IDB into the domain of the Council's members during 1960 and 1961.

[20] Indeed, the Bank is to be credited with having taken prompt and effective action during the latter part of 1965 to stabilize the seriously deteriorating situation that developed after Atlantic Acceptance failed.

definitely contributed to the evolution of an environment in which these <u>contretemps</u> became increasingly possible. The Bank also committed errors of omission during these and later years, the most serious of which was its failure to promote a healthy liaison with the industry. It permitted, in other words, the rebuff that it had experienced in the mid-'fifties to set the diplomatic tone long after it had lost much of its relevance. When testifying before the Porter Commission in 1962 industry representatives repeatedly expressed their desire for contacts with the Bank on a reciprocal and continuous basis.[21] If these expressions had been responded to (and tested) during the early 'sixties to a greater degree than is visible to an outside observer, it is not inconceivable that the industry's vulnerability might have been recognized and perhaps mitigated.

The Bank's experience during the decade under review with commodity instalment credit testifies above all to the limitations of monetary policy, especially when uncoordinated with fiscal policy. Apart from its probably inapplicable option of asking the government to regulate down payments and repayment intervals, the only devices available to it after 1952 were inherently incapable of attacking the roots of the problem, namely the high levels of demand for automobiles and consumer durables generally. The Bank could only attempt to curtail the supply of commodity instalment credit and it found, as did some of its counterparts in other countries, that the main institutional targets were largely beyond the scope of its writ.

[21]See, for example, <u>FCSFC</u>, pp. 99-100.

Given its roots, there is, as we have seen, no easy policy prescription for the problem of excessive commodity instalment credit that will be appropriate to all seasons. When it arises it must, like other manifestations of unduly high demand, be dealt with by a variable mix of fiscal and monetary measures. There must exist, as an indispensable precondition, an intimate and cooperative relationship between the various policy makers. There must also exist an active rapport and a mutual feeling of confidence among the financial institutions involved. It is encouraging to observe that the current management of the Bank of Canada and the Ministers of Finance of the past few years seem to have been more conscious of the former consideration than some of their predecessors were. The same, it seems, can also be said with respect to the latter consideration. As the writer learned while gathering data for this study, discussions have taken place recently between the Bank and representatives of a severely chastised sales finance industry, with results that augur rather favourably for the future.

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